S T A T E O F M I C H I G A N

STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the Application of	)	
Consumers Energy Company for	)	Case No. U-16149
Approval of a Gas Cost Recovery Plan and	)	
Authorization of Gas Cost Recovery	)	
Factors for the 12 month period	)	
April 2010 – March 2011.	)	

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on September 14, 2010.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before September 30, 2010, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before October 14, 2010. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing of exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for

Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

Mark D. Eyster

Digitally signed by Mark D. Eyster
DN: cn=Mark D. Eyster, c=US, email=mdeyste@michigan.gov
Date: 2010.09.14 13:25:04 -04'00'

Mark D. Eyster
Administrative Law Judge

September 14, 2010
Lansing, Michigan
dmp

S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

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PROPOSAL FOR DECISION

HISTORY OF PROCEEDINGS

On December 30, 2009, Consumers Energy Company (Consumers or CECo) filed this application requesting approval of its gas cost recovery plan (GCR Plan or Plan) and factors for the 12-month period ending March 31, 2011. Consumers' application was filed pursuant to Section 6h of 1982 PA 304 (Act 304), MCL 460.6h.

A prehearing conference was held February 9, 2010, before Administrative Law Judge Mark D. Eyster. At the conference, counsel appeared on behalf of Consumers, the Michigan Public Service Commission staff (Staff), the Attorney General for the State of Michigan (Attorney General), the Residential Ratepayer Consortium (RRC), the Michigan Community Action Agency Association (MCAAA), and Direct Energy Services, LLC and Interstate Gas Supply, Inc, jointly, as Gas Choice Interveners (GCI). Intervenor status was granted to the Attorney General, RRC, MCAAA , and GCI[1] and a schedule for the remainder of the case was established.

[1] On March 18, 2010, on appeal, the Commission denied GCI's petition to intervene.

Pursuant to that schedule, Staff and Intervenor testimony and exhibits were filed on April 15, 2010, rebuttal testimony and exhibits were filed on May 6, 2010, and cross-examination was conducted on June 1, 2010. On June 29, 2010, Consumers, the Attorney General, RRC, and Staff served their initial briefs. On July 20, 2010, each of these parties filed reply briefs.

EVIDENCE REVIEW

The evidentiary record is found in a 470 page transcript and 59 exhibits. Following is a summary of the evidence presented by the parties.

Consumers

Overview

Consumers presented the following witnesses:

- Shawn D. Burgdorf, General Engineer in the Transmission and Regulatory Strategies Section of Electric and Gas Supply, described the legal and regulatory actions taken by Consumers related to gas acquisition.

- Linda J. Clark, Senior Business Support Consultant in the Rates and Business Support Department, testified to Consumers' forecast of gas sales and transportation volumes for the GCR years of April 2010 through March 2015.

- Lori M. Harvey, Principal Engineer Lead in the Financial and GCR Strategic Planning Section of the Gas Management Services Department, presented testimony to: 1) describe the modeling process that is used to develop the colder than normal (CTN) and normal weather purchase plan estimates, 2) describe key model assumptions, 3) provide the storage utilization results from these analyses, 4) describe the purchase decision process that will be used during the plan year, and 5) describe the key components used in the calculation of the quarterly ceiling price adjustment mechanism.

- David W. Howard, Director of Gas Supply, presented testimony to address the expected sources and volumes of gas supply, anticipated gas cost changes, major contracts and gas supply arrangements, and the five-year forecast of gas requirements.

- Erin A. Rolling, Senior Rates Analyst I in the Rates and Business Support Department, testified about Consumers' proposed GCR factors.

In addition, Consumers presented 44 exhibits.

<u>GCR Factors</u>

Per Ms. Rolling, Consumers is requesting approval of GCR factors consisting of the sum of a base factor of not less than $6.9934 per Mcf, as found in Exhibit A-32, and additional amounts, contingent upon future events, calculated pursuant to the GCR Ceiling Price Adjustment Mechanism (contingency mechanism) found in Exhibit A-33.[2] Tr 2, p. 115. To calculate the base factor, "[t]he cost of non-GCR gas was subtracted from the total cost of gas supply for the twelve-month period . . . . The resulting difference was then divided by the forecast sales volumes in MMcf . . ., less the assumed Gas Customer Choice load . . . . This resulted in an average cost of gas sold of $6.9934 per Mcf." Tr 2, p. 115

<u>Contingent Ceiling Price Adjustment Mechanism (Contingency Mechanism)</u>

As originally proposed in its filing, Consumers contingency mechanism continues the use of a quarterly contingent ceiling price adjustment mechanism "to adjust the

[2] With regard the contingency mechanism, Consumers final position is that the Commission adopt Staff's proposal, discussed below, and that its contingency mechanism be adopted only in the alternative.

ceiling factor upward if the [NYMEX] natural gas prices increase above levels used in determining the base GCR factor." Tr 2, p. 269. As proposed, Consumers' mechanism would use "the higher of the change in the entire 12 month GCR NYMEX price strip or the change in the remaining GCR NYMEX strip from the Plan NYMEX each quarter", "a \$3 ceiling factor cap to the change in NYMEX prices", and "a revised and levelized fractional multiplier of 0.394". Tr 2, p. 270. Therefore, under Consumers' proposal, "the contingent GCR ceiling price could increase up to \$8.1754 [6.9934 + (39.4% x \$3.00)] if the maximum adjustment were to occur." Tr 2, p. 269.

To support its proposed use of the NYMEX price strip, Consumers' witness, Ms. Harvey, testified, at Tr 2, pp. 271-72, that:

> The Company is proposing to use the higher of the change in entire 12 month or remaining NYMEX price strip from the Plan NYMEX in the calculation to capture impacts of NYMEX price changes and market direction changes throughout the entire GCR period regardless of market direction. In the summer period and during the 1st and 2nd Quarter, the Company is incurring more purchase costs than it is recovering through sales due to summer storage injections. These purchase costs are not fully recovered until the gas is withdrawn from storage in the 3rd and 4th Quarter and sold to the GCR customer. Approximately 75% of the Company's GCR sales (deliveries) occur in the 3rd and 4th Quarter (143,140 / 188,746 * 100) as shown in Exhibit A-23 (DWH-3), line 5.
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> * * *
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> During the summer of 2008, the NYMEX prices for the April 2008 through March 2009 GCR period increased by over \$5/MMBtu. This NYMEX increase led to significant increases to summer purchase costs and the cost of gas in storage. This large NYMEX increase was followed by a large decrease in NYMEX prices in the winter and remaining period at the time of the establishment of the 3rd and 4th Quarter ceiling factors. As a result, the 3rd and 4th Quarter ceiling factors, based on the remaining price strip during the GCR 08/09 period, resulted in the ceiling factors being established at the base factor level. The filed base factor was not sufficient to allow recovery of the costs incurred earlier during the GCR period and lead to an actual under-recovery of about \$16 million for the GCR 08/09 period. In this particular case, if the Company would have been able to use the change in the entire price strip, then the 3rd and 4th

> Quarter ceiling factors would have partially reflected the cost increases and would have likely provide [*sic*] the Company an opportunity to recover the summer cost increases during the 3rd and 4th Quarters.
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> * * *
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> The NYMEX close prices used in the entire strip calculation each quarter may not fully reflect actual costs incurred to date and may not fully reflect the impacts of future market increases on the Company's ability to recover its cost in the GCR year given the Company's levelized method for establishing its month billing factor. In the situation of increasing NYMEX prices, using the entire strip would average down the impacts of the actual costs the Company will be incurring in the future when purchasing gas to serve customers in the remaining period. Averaging down the impact of the NYMEX change could result in a ceiling factor that is not high enough for full recovery. In this situation, using the change in the remaining strip would be more appropriate.

Regarding the ceiling factor cap of $3.00/MMBtu, Ms. Harvey states, at Tr 2, p. 273:

> The Company believes a $5/MMBtu cap is more representative of the potential magnitude of natural gas NYMEX market volatility that exists but is willing to agree to a lower cap in this plan case if the other two components, the filed fractional multiplier and higher of NYMEX strips, are included to help mitigate the lower dollar amount of the cap.

To justify the fractional multiplier, Ms. Harvey states, at Tr 2, p. 273:

> This fractional multiplier of 0.394 (39.4%) was calculated by computing the current percentage of natural gas that is not under contract or at index prices at the time of the filing and has associated costs that will vary with NYMEX price changes. The percentage of the total purchase requirements at fixed price is 60.6% as shown on Exhibit A-23 (DWH-3) line 10. . . . The amount of gas at index is 76,759 MMcf and is . . . shown as gas volume not under contract on line 20 of Exhibit A-23 (DWH-3). The resulting percentage of gas at index is 39.4% (76,759/194,694 * 100).
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> While the percentage of gas at index will likely decreases [*sic*] by quarter, it would not be appropriate to decrease the fractional multiplier. There are other variables that effect recovery such as changes in cycle billed volumes, sales volumes, purchase volumes, timing differences between cost changes and the establishment of the ceiling factors. Maintaining a level fractional multiplier will allow some small amount of

flexibility to make adjustments in the billing factor to reflect changing circumstances.

Delivery, Sales, and Customer Estimates – 2010-2015

At Tr 2, pp. 91-94, Consumers' witness, Linda J. Clark, testified about Consumers' forecast methods and stated:

> The techniques used to forecast gas deliveries (sales plus transportation) vary from customer class to customer class based upon the availability of information. However, in general, these forecasts were based primarily on regression analyses. Examples of the independent variables used in the forecast models include economic variables . . . and heating degree-days.
>
> The four major classes of gas deliveries that are forecasted are residential, commercial, industrial, and interdepartmental. Some of the classes are broken down into more detail. These annual forecasts are developed from cycle-billed data from customer records. The annual forecasts are allocated to monthly volumes using factors developed from weather-normalized historical data.
>
> Three primary methodologies were used to forecast 2010 – 2015 gas deliveries. One method used was regression analysis, a mathematical and statistical tool that correlates the relationship between dependent variables (deliveries, average use, or customers) and the independent variables (economics and/or weather). By applying these relationships to the forecast of the independent variables, projections of the dependent variable can be made. Regression models were used to forecast residential space heating use, residential domestic use, residential A-1 use, commercial deliveries, industrial other deliveries, and General Motors deliveries. The second methodology, exponential smoothing, was used to forecast residential domestic customers, A-1 customers, commercial customers, and industrial customers. Exponential smoothing simply involves the use of the exponentially weighted moving average model, which assigns heavier weights to recent values of the dependent variable. Professional judgment was used to forecast residential space heating customers and interdepartmental deliveries. All forecast methodologies use professional judgment to some extent. When none of the above methodologies are applicable, the forecaster must rely on his or her judgment. This includes such techniques as trending, and looking at current and future events affecting sales.
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> After the cycle-billed forecast of total deliveries by class is developed, a forecast of transportation, by class, is made by trending historical percentages. The gas sales forecast is the gas deliveries forecast less the gas transportation forecast. If necessary, the impacts of future factors or "forward-looking items" not fully present in past data, such

> as energy optimization impacts, are developed independently and directly applied as adjustments to the base forecast.
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> . . . The deliveries forecast is a weather-normalized forecast, based on the assumption that normal weather will occur during the forecast period.
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> It should be noted that actual heating degree days and actual deliveries are used in the regression models, not weather-normalized volumes. The monthly historical gas deliveries are weather-normalized using coefficients developed from regression analyses of monthly historical data for residential space heating use per customer, residential A-1 use per customer, commercial deliveries, industrial other deliveries and General Motors deliveries. These coefficients are reviewed frequently. The calculated coefficients are multiplied by the difference between actual heating degree days for the month, and the normal monthly heating degree days. This correction is then added or subtracted to the monthly use or deliveries, depending whether the actual heating degree days were below or above normal, respectively.
>
> The normal level of heating degree days used to forecast gas deliveries in the forecast models was developed by taking an average of the most recent 15 years (1994 – 2008) of historical heating degree days.

At the time of filing, in Exhibit A-2, Ms. Clark presented Consumers' estimated total gas sales of 222,382 MMcf for April 2010 through March 2011, broken down by customer class and month, as well as, totaled. For the 2011-12, 2012-13, 2013-14, and 2014-15 years she estimated sales of 216,913 MMcf, 211,061 MMcf, 201,731 MMcf and 204,373 MMcf, respectively. Exhibit A-3. In Exhibit A-4, Consumers' gas transportation estimate for 2010-2011 is broken down by month and class and totals 55,611 MMcf. Exhibit A-5 shows Consumers' transportation estimates for the 2011-12, 2012-13, 2013-14, and 2014-15 years of 54,590 MMcf, 53,951 MMcf, 53,542 MMcf, and 53,058 MMcf, respectively.

In rebuttal, Ms. Clark presented a revised gas sales forecast for 2010-11 of 213,336 MMcf. Exhibit A-37. Also, in response to a computational error identified by the RRC, she revised Consumers' monthly allocations for 2010-11. Tr 2, p. 106. In doing so, she partially adopted the RRC's proposal that the allocations be based on an 11-year average by, instead, opting for a four-year average. Tr 2, p. 106. The new allocation percentages and corresponding monthly sales totals are found in Exhibit A-37. Originally, Consumers had allocated 74.9% of its gas sales to the November thru March heating season. Under its new calculations, Consumers allocates 73.6% to those months, compared to the 73.7% allocation projected by the RRC. Tr 2, p. 108.

In Exhibits A-11 and A-12, Consumers presents estimates for the number of customers it expects for years 2010-2014. The estimates for 2010 and 2011 show a steadily declining customer base across all categories. For 2012-14, the customer estimates vacillate within an overall downward trend.

Colder Than Normal (CTN) Weather Planning

> Consumers Energy's GCR Plan is based, in general, on normal weather occurring throughout the entire winter on an even and predictable basis. However, the Company must also make provisions to meet a colder than normal winter, a warmer than normal winter, and peak day occurrences. Both the GCR purchase and storage utilization plans are impacted by forecasted supply patterns and storage activities of Consumers' non-GCR customer groups as well as system capabilities and constraints. For this reason, the GCR Plan is developed through modeling of the entire integrated Consumers system. Total system analyses are completed to ensure the contractual obligations, storage utilization, peak day, and monthly delivery requirements for all customer groups are being met within the constraints of Consumers' integrated natural gas storage, transmission and compression system. Tr 2, pp. 242-43.

Consumers' conducts its total system analysis through the use of a software program called "Sendout", "a proprietary linear optimization programming model". Tr 2, p. 243. The programming model "is used to simultaneously consider system, economic, and operational parameters while it determines the optimal use of the

Company's resources in a way that meets projected delivery requirements on a least variable cost basis within the constraints of the system." Tr 2, p. 243. In its modeling, Consumers "assumes that an approximate 1 in 25 year occurrence rate of insufficient supply is an acceptable risk level", i.e., "a 4% probability level". Tr 2, p. 245.

Consumers models five CTN scenarios: design CTN November through March; normal November with CTN December through March; normal November and December with CTN January through March; normal November through January with CTN February and March, and; normal November through February with CTN March. Tr 2, pp. 244-45. At Tr 2, p. 290, Ms. Harvey explains that:

> The GCR purchase requirements for the winter months in each scenario are established at a level that is sufficient to meet the GCR monthly and the peak day delivery requirements . . . within the constraints of the physical system. The GCR purchase requirements are a function of how the model utilizes storage. The Company strives to optimize its storage field utilization throughout the Plan year but particularly during the winter season in an effort to minimize the cost of gas sold to its GCR customers. It does so by planning on maximizing the withdrawal capabilities of its storage fields under various scenarios with specific inputs and reducing the purchase of winter supplies that are generally higher priced than supplies injected into the Company's storage fields. This is demonstrated in the monthly purchase plans in Exhibit A-28 (DWH-8) page 3.[3]

Design and Peak Day Winter Requirements

In Exhibit A-28, Consumers outlines its peak day requirements for both normal and CTN winters. Consumers estimates that it will require 492 MMcf/d to meet CTN design day for January 31, 2011. Tr 2, p. 153.

Consumers "utilizes a 4% probability of a colder than normal winter for the design winter case and an 80 heating degree-day assumption for January peak day." Tr 2, p.

[3] For a more detailed explanation of CTN planning, see Tr 2, pp. 247-61.

153. Adoption of the 4% probability figure is designed to protect Consumers' system for up to 13% more degree-days than normal for November through March. Tr 2, p. 153.

Warmer Than Normal Weather Planning

To allow for a warmer than normal winter, Consumers plans to have only approximately 90% of its winter requirements under fixed price contracts at the start of the winter heating season. Tr 2, pp. 154-55.

Incremental Winter Purchases

At Tr 2, pp. 267-68, Consumers' witness, Ms. Harvey, describes Consumers' decision making process for incremental purchases as follows:

> The decision whether to buy incremental supplies is accomplished in two steps. Each month during the first eight work days a new monthly GCR purchase and cost of gas supply forecast is developed incorporating the previous month's actual data, an updated price forecast and inventory guidelines from the normal and design cold plan case. This analysis is then reviewed starting at mid-month incorporating actual non-GCR customer storage and supply activity during the first part of the month**,** current individual storage field inventories, forecasted storage capability, estimates of weather for the remaining part of the month, operational changes occurring on the system, peak day requirements and a 4% probability of CTN weather design for the remainder of the winter months. As result of this updated analysis decisions are made on incremental purchases [*sic*]. This methodology ensures that the purchase decision is based on the most current information available.
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> The purchase decision for a month is generally made approximately 1 to 2 weeks prior to the start of that month. The purchase volume would be established at a level low enough to maximize available storage withdrawal capability in the remaining period, but also high enough to provide sufficient cold weather reserve in inventory to cover a peak day and 4% design colder than normal weather in the remaining period. If actual weather has been fairly normal or warmer, then storage field inventories will be higher. The higher inventories and the associated individual field capabilities for the remaining period, along with other factors, would be incorporated into the analysis for subsequent purchase decisions.

Late Season Incremental Purchases

In response to the Commission's statements, in Case No. U-15041-R, that "there appears to be some evidence that the company's late-season purchasing strategy could be improved" and that "Consumers may wish to present a refinement to its purchasing methods in a future GCR plan proceeding", Ms. Harvey states, at Tr 2, p. 250. that:

> In this plan year, the analysis will be updated . . . in the spring with another winter's worth of data. Additionally, as the plan year winter progresses the combined daily GCR/GCC and transport gas use and daily weather data is gathered. By about mid February sufficient data should be available to make an estimate of gas use per HDD and the maximum daily sendout expected for any day during the month of March using the updated data. This late winter update would use the same analysis techniques used for the full season analyses and would potentially impact the incremental delivery requirements for 4% design in the remaining period and the peak day design requirements.

Consumers' witness, Mr. Howard, added testimony regarding the advisability of delaying March incremental purchases. In Mr. Howard's opinion delaying such purchases "to make incremental purchases weekly or daily rather than at the beginning of the month would not be appropriate." Tr 2, p. 155. He states that do so "would create operational uncertainties and would increase both supply risk and cost risk to customers." Tr 2, p. 155. At Tr 2, p. 156, he, further, explains:

> The methodology used by the Company takes into consideration the operation of the Company's integrated system under design conditions while meeting the needs of its customers. Delaying the incremental March 2011 purchases would create uncertainties regarding: 1) the level and basis of purchases that should be planned for prior to the start of the month, 2) the timing associated with making incremental purchase decisions, 3) the basis for the incremental purchases during the month for the remaining period, and 4) the impact of operational constraints. In contrast, the Company's approved approach of using a 4% design probability is a direct risk based approach. Guessing wrong on the amount needed and the timing of the incremental purchase could have dire consequences if the gas is not available when needed at any time on any day during the winter. Additionally, delaying purchases to later in the

> month could require the purchase of potential high volumes in short periods to meet the remaining loads and peak day requirements. This incremental volume may not be available, especially during cold periods when supply is in high demand. If the Company is experiencing cold weather, then most, if not all, of the Midwest will also be experiencing cold weather. Also, if the Company purchased at the last minute, the prices could be substantially higher. In addition, the gas supply available from storage fields has to be balanced with the timing of supplies. There could also be difficulties due to capacity constraints or pressure constraints.

Gas Supply

In general terms, as described by Consumers' witness, David W. Howard, at Tr 2, p. 141:

> Consumers' gas supply plan is based on the forecasted sales requirements of its customers . . . . The Plan features a portfolio of geographically diverse sources of supply consisting of fixed price and indexed price contracts as well as the use of firm pipeline transportation. . . . [Consumers' purchasing] . . . strategy . . . consists of both Tiered Fixed Priced Purchase Guidelines and Quartile Fixed Price Triggers Guidelines. [Consumers] purchases monthly index supply as necessary and employs its extensive underground natural gas storage assets to manage variances in customer demand and to take advantage of historically lower priced summer supplies. The Plan and strategies are subject to adjustments before and during the GCR period as a result of actual overall inventory levels, changes in weather and associated forecasts, changes in requirements and pipeline integrity compliance and operations.

Gas Purchasing Guidelines

Exhibit A-21 is a copy of Consumers' originally proposed Gas Purchasing Strategy Guidelines. In it, Consumers details its Tiered Fixed Price Purchase Guideline and its Quartile Fixed Price Triggers Guideline. Under the Tiered Fixed Price Purchase Guidelines, Consumers' strategy "is to have at least 15% to 20% of the gas requirement for the GCR period under fixed price contracts by December 1st of the preceding period, 25% to 30% by the following April 1st, 35% to 40% of winter requirements (Nov – March), by July 1st, and 50% of winter requirements by October 15th of the Plan year."

Tr 2, p. 142. See Exhibit A-21. Under its Quartile Fixed Price Triggers Guideline, Consumers fixes the price of a portion of its supply requirements when the market price is within or below certain historical price quartiles. Tr 2, p. 144. As proposed, at Tr 2, p. 144, under this guideline:

> Upon settlement on the last trading day for each monthly NYMEX natural gas contract, Consumers determines the average of the settlement prices for the NYMEX contract that has settled for the current month plus the next consecutive eleven monthly settled NYMEX contracts. This 12 month average strip price will be summarized along with the comparable 12 month average strip prices for the previous 35 months. All 36 prices will be sorted from lowest to highest and grouped into four quartiles. The 9 lowest prices represent the First Quartile; the next 9 prices are the Second Quartile and so on. If the current market price of gas falls into (i) the Second Quartile, (ii) the First Quartile, or (iii) below the First Quartile, Consumers would then implement measures to fix prices on a portion of its supply requirements for the balance of the current year and the next four years.

At the time of filing, Consumers had made fixed price purchases for 62% of its summer needs and 58% of its winter needs. Tr 2, p. 143. For the remainder of the 2010-2011 GCR period, Consumers "intends to purchase the remaining supplies at index prices with a right to trigger to fixed prices if the NYMEX pricing falls within the designated quartile fixed price trigger guidelines." Tr 2, p. 147.

In rebuttal, Consumers presented testimony to support amending its Plan to bring it into conformity with the current guidelines, as ordered by the Commission in Case No. U-15704. Tr 2, p. 165. Those changes include limiting the guidelines to four years, rather than five years, permitting fourth year purchases only when prices are in the first quartile or below, and limiting fourth year purchases to 20% of the estimated annual supply requirements. Tr 2, p. 165.

Gas Procurement and Sources

> Consumers currently has access to natural gas supplies from several basins throughout North America. Canadian supply is sourced from the AECO supply basin located in the province of Alberta, Canada and transported to Consumers on both the Great Lakes and ANR pipelines. Chicago supply is sourced at the Chicago hub and transported to Consumers on the Vector pipeline. Gulf Coast supply is sourced both on and offshore in the Gulf of Mexico and transported to Consumers on Trunkline pipeline. Mid-Contintent [*sic*] supply is sourced in the mid-continent basin located in the Oklahoma panhandle, Kansas and north Texas, and transported to Consumers on Panhandle pipeline. Rockies supply is sourced off the Rockies Express Pipeline (REX) that interconnects with Panhandle and Trunkline. Citygate supply is sourced at Consumers' citygates. Tr 2, p. 150. Exhibit A-24

Exhibit A-25 summarizes Consumers' firm and interruptible transportation contracts with Trunkline Gas Company, ANR Pipeline Company, Great Lakes Gas Transmission Company, Panhandle Eastern Pipeline Company, and Vector Pipeline. Tr 2, pp. 150-51. Consumers plans to sell excess transportation capacity through the pipelines' capacity release programs. Tr 2, p. 151.

In Exhibit A-27, Consumers sets forth the average NYMEX pricing of natural gas for the plan year through March 2015. Consumers uses the NYMEX as a reference point for future natural gas commodity prices because it is only recognized pricing tool used in the natural gas business. Tr 2, p. 152.

Storage

Consumers has fifteen storage fields each with different injection and withdrawal capacities. Tr 2, p. 157. Nine operate as base load storage fields and six as peak load storage fields. Tr 2, p. 261. The maximum storage capacity of these fields is 135 Bcf. Tr 2, p. 157. However, due to operational constraints, the system is only capable of handling between 110 and 125 Bcf during each injection and withdrawal cycle. Tr 2, p.

157. See Exh A-30. A detailed description of Consumers' storage field utilization is found at Tr 2, pp. 261-67.

Gas Customer Choice

Consumers estimates that gas customer choice (GCC) suppliers will secure 37.6 Bcf for the GCR year. Tr 2, p. 159. However, Consumers indicates that, because of the "current gas price environment", it does not know how customers and GCC suppliers will react and that "[s]ignificant changes in the GCC market could alter [Consumers'] purchase and transportation requirements." Tr 2, p. 159.

Legal and Regulatory Actions

At Tr 2, pp. 123-24, Shawn D. Burgdorf, General Engineer in the Transmission and Regulatory Strategies Section of Electric and Gas Supply, testified to the gas acquisition related legal and regulatory actions taken by Consumers. Exhibit A-1 shows the FERC dockets that Consumers intervened in during 2009. Mr. Burgdorf indicated that Consumers participates in FERC and court proceedings that may materially impact the cost of gas or the availability of necessary interstate gas transportation. He indicated that Consumers monitors and intervenes in proceedings involving the major interstate pipelines serving Consumers to ensure that transportation capacity is provided at reasonable prices and conditions. Additionally, Consumers works through the American Gas Association to advocate before FERC regarding policies to foster reliable and cost-effective gas transportation service.

Staff

Nyrhe U. Royal, Public Utilities Engineer for the MPSC, presented Staff's recommendations on Consumers' request to modify its contingency mechanism and the

Commission's statement, in Case No. U-15704, encouraging Consumers to engage in discussions to identify changes for its purchasing guidelines.

Contingency Mechanism

Regarding the contingency mechanism, Staff recommends a levelized fractional multiplier of 0.3313 and a contingency adjustment cap of $2.50/Mcf. Tr 2, pp. 449, 451. Exhibit S-1. Exhibit S-2. Ms. Royal then explains, at Tr 2, pp. 449-51.

> Consumers is requesting that the Commission approve a Contingency Mechanism similar to the one approved in Case No. U-15704. . . Since the quarterly GCR factor Contingency Mechanism incorporates the same fractional multiplier for each quarter and the same NYMEX futures prices cap in the calculation of GCR ceiling price adjustment; it is Staff's opinion that this calculation is equivalent to a maximum annual GCR factor. . . . For the 2010-2011 GCR plan year, Staff recommends that the Commission approve a base ceiling factor and a single maximum allowed GCR factor based on one levelized fractional multiplier and the maximum recognized NYMEX increase.
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> This simplification is preferable for the following reasons: 1) it does not require a comparison between the current 5-day average for the 12-month NYMEX strip for April 2010 through March 2011 and the 5-day average in December 2009 for the 12-month NYMEX strip for April 2010 through 2011; 2) it is easier to understand and administer; 3) it may decrease the chance of Consumers having either an under-recovery or over-recovery because the billed GCR factor would be more responsive to price changes in the NYMEX market; 4) tariff sheet D-5.00 (quarterly gas cost recovery (GCR) factor ceiling price adjustment (Contingency) mechanism), would be removed from Consumers' rate book; and 5) it provides Consumers' GCR customers with more certainty in the amount they could be billed throughout the GCR plan year.
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> This mechanism would not require: 1) a comparison of the NYMEX strips; and 2) intra-plan factor calculations to be submitted to Staff.

Under Staff's proposal "the maximum allowed GCR factor adjustment" equals $7.8217/Mcf.[4] Tr 2, p. 452.

[4] $6.9934/Mcf + (0.3313 x $2.50/Mcf) = $7.8217/Mcf

Purchasing Guidelines

With regard to the Commission's suggestion that the parties work toward identifying changes to the purchasing guidelines,[5] Staff states, at Tr 2, p. 453:

> Staff recommends that Consumers take the initiative and provide its version of gas purchasing guidelines based on its expertise and knowledge of its system operations. Whether the Company's proposed gas purchasing guidelines are completely different or affirm what is currently in place, Staff maintains that this should be the starting point for further discussions concerning the gas purchasing guidelines. In the meantime, Staff recommends that Consumers should continue to utilize the guidelines as modified by the Commission order in [C]ase No. U-15704.

Attorney General

The Attorney General's witness, Ralph E. Miller, an independent consulting economist, presented testimony addressing proposed contingency mechanisms, Consumers' proposed fixed price purchasing guidelines, and Consumers' operational planning. Additionally, he sponsored Exhibit AG-1.

Contingency Mechanism

Mr. Miller opposes Consumers' proposal to use two methods of calculating the change in NYMEX strip prices for use in calculating quarterly contingency factor adjustments. Instead, Mr. Miller recommends that Consumers be limited to use of only the change in the NYMEX prices for all 12 months of the GCR year. Tr 2, p. 316. Mr.

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[5] In Case No. U-15704 the Commission stated, at page 18 of its March 2, 2010, Order:

> The Commission observes that Consumers' purchasing guidelines were developed at a time when gas costs were trending upward and that the guidelines do not perform as well in the unstable market that the utilities have faced in recent years, and may continue to face for some years to come. The modifications to the purchasing guidelines adopted here begin to address the issues that arise in a volatile market, nevertheless, the Commission finds that the parties should be encouraged to engage in discussions designed to identify changes to the guidelines that may be implemented in future GCR plan years.

Miller notes that, in Case No. U-15704, the Commission agreed with his position. Tr 2, pp. 316-17.

Mr. Miller is critical of a Consumers' discovery response related to this topic. In an interrogatory, Consumers was asked to present actual or hypothetical examples to support its claim that use of "the entire NYMEX strip does not 'fully capture the impacts of NYMEX price increases throughout the entire period' and that 'using the entire strip would average down the impacts' of higher prices occurring in just the remaining months." Tr 2, pp. 317-18. In response, rather than attempting to comply with the discovery request, Ms. Harvey stated, in Exhibit AG-1:

> The basis for the Company's proposal to use the higher of the entire or remaining strip instead of the entire strip is discussed in my direct testimony in this case starting on page 32 and at length in my rebuttal testimony in Case U-15704 starting on page 4. Please refer to the referenced testimony. Lowering the potential difference between the ceiling factor and required GCR billing factor increases the risk and potential magnitude of under-recoveries.

Additionally, Mr. Miller opposes Staff's proposed GCR base factor of $7.8217 and recommends the base factor of $6.9934, as proposed by Consumers. Mr. Miller testified that he has examined the NYMEX futures market since December 2009 and found that Staff's recommendation is not justified by increased gas costs. Mr. Miller states that Staff's proposal "ignores symmetry because it increases the maximum allowable GCR factor even if there is no NYMEX price increase, and it retains the higher factor throughout the GCR year no matter what happens to NYMEX prices." Tr 2, p. 335. He continues by stating that Staff's desire for simplification and greater certainty in billing do not warrant "abandonment of the use of cost-based maximum for the allowable GCR factor. Tr 2, p. 336. Mr. Miller adds, at Tr 2, p. 338:

> Staff's recommended factor provides less information about a customer's likely bill than the present contingency mechanism. The reason is that Staff's recommended factor is not a realistic representation of the amount that a customer is likely to be billed and is not based on any reasonable expectation of the GCR cost of gas that Consumers is likely to incur.
>
> If the Commission is concerned that the customer needs to know the maximum GCR factor that could possibly be billed using a true contingency mechanism, the appropriate way to achieve this result is to place a statement showing this ultimate ceiling price on tariff sheet D-2.00, in addition to the information showing the current cost-based maximum allowable factor.

Mr. Miller also disputes Staff's claim that the higher factor would lessen the likelihood of under- or over-collections; noting that "any factor can result in an under-recovery or an over-recovery." Tr 2, p. 336.

Finally, Mr. Miller argues that Staff's proposal will likely raise the cost of gas. To support this conclusion, he states, at Tr 2, pp. 339-40:

> Competitors and choice customers are apt to rely upon an unreasonably high approved factor in offering and deciding to make Choice arrangements. If the maximum allowable GCR factor does not reflect a utility's reasonably expected gas costs, then it is much more difficult for the Commission or the parties to a GCR plan proceeding to examine those projected gas costs carefully and in detail because analysis becomes more subjective and uncertain. A natural result is that GCR reconciliation proceedings may fail to address carefully the reasonableness of the utility's actual costs because the utility never has to justify a large under-recovery, even when it may have incurred unnecessary costs, because the unnecessary costs are masked by billing higher GCR factors.

<u>Gas Purchasing Guidelines</u>

Mr. Miller testifies that the Commission should adopt purchasing guidelines similar to those approved in Case No. U-15704, but calls for their termination after March 31, 2011. Mr. Miller states, at Tr 2, p. 319:

> If the Commission approves gas purchasing strategy guidelines for Consumers, it should . . . approve Guidelines based on those it adopted in

> its March 2, 2010 order in U-15704, but the Commission should now restrict Consumers' reliance upon these guidelines to contracts entered into by March 31, 2011, which is the last day of the GCR annual period addressed in this case. The Commission should not . . . approve relying upon any gas purchasing strategy guidelines beyond March 31, 2011. The Commission should instead wait for a report and any recommendations that may be forthcoming from the collaborative effort now being organized pursuant to prior MPSC orders. There is ample time for the collaborative to meet, conduct its business, and present any report and recommendations it may develop by October or November of this year (2010). These results would then be available for Consumers and the other Michigan gas utilities to use in formulating their GCR plans for 2011-2012, which are due to be filed in December 2010. The Commission can then use the report and recommendations of the collaborative, together with those GCR plans for 2011-2012, as a basis for its consideration of gas purchasing strategy guidelines to be effective after March 31, 2011. The Commission may also wish to establish a deadline, perhaps in October or November of this year (2010), for receiving a report and recommendations from the collaborative or from the Staff if the collaborative is unable to agree on a report.
>
> Mr. Miller justifies this approach by stating, at Tr 2, pp. 321-22:
>
> If the Commission limits the applicability of any gas purchasing strategy guidelines approved in the present proceeding, it will be sending an appropriate signal that it considers the work of the collaborative to be very important. If the Commission approves gas purchasing strategy guidelines to be applied to contracts executed after March 31, 2011 and until superseded, the Commission will instead be sending a message that there is no need for a thorough review of gas purchasing strategies. Approving guidelines without a March 31, 2011 time limit would signal (1) that parties should continue with business as usual, which emphasizes differences in GCR plans and sacrifices long-term policy concerns, and (2) that a more comprehensive review is unnecessary even though the Commission has previously ordered collaborative reviews.

Mr. Miller testifies that the Commission should modify the guidelines it approved in Case No. U-15704 by capping the second quartile purchases for delivery during the third GCR year at 20% of Consumers' projected requirements for that year. Mr. Miller justifies the cap by stating that "[f]ixed price purchases under guidelines in effect for the past several years have increased costs for Consumers' GCR customers by hundreds of millions of dollars, compared to the costs Consumers would have incurred if it had not made any fixed price purchases." Tr 2, p. 322. Mr. Miller adds, at Tr 2, pp. 323-34:

> This problem has occurred because Consumers applies its Guidelines as allowing purchases at Second Quartile prices all the way up to the caps on the total fixed price purchase quantity for each GCR year, and those caps are now far higher than needed to achieve a reasonable measure of GCR factor stability. The annual cap for fixed price purchases in the Third GCR Year is now 60% of the projected total requirements, and that cap is increased to 70% for purchases at prices Below the First Quartile.
>
> * * *
>
> Conditions in the natural gas market have now changed to the extent that Second Quartile prices are no longer favorable purchasing opportunities. Second Quartile purchases should therefore be capped at levels that can be justified entirely on the grounds that some level of fixed price purchases is needed for GCR factor stability. The levels that the Commission has found to be justified on that basis are the Tiered Purchase Guideline targets. Under the Guidelines approved in U-15704, the first of the Tiered Fixed Price Purchase Guidelines applicable to the 2012-2103 GCR year is a target of 15% to 20% fixed price coverage at December 1, 2011. The 2012-2013 GCR year is the Third GCR Year only through March 31, 2011, which is eight months before that first Tiered Purchase Guideline of 15%-20% fixed price coverage is reached. There is no price stability justification for fixed price coverage of 60% of the 2012-2013 requirements—which is triple the top of the December 1, 2011 target for 2012-2103—at March 31, 2011, which is a full 12 months before the beginning of the 2012-2103 GCR year. The only possible justification for fixing the price of such a large percentage of the 2012-2013 requirements at such an early date would be an expectation supported by quantified evidence that the prices for those purchases are favorable. And purchases at Second Quartile prices do not pass this test. They should therefore be capped at a much lower level than 60%, at least until after April 1, 2011.

Finally, Mr. Miller testifies that the Commission should clarify that "the 2012-2013 GCR year will remain the Third GCR Year through March 31, 2011, and that it will not become the Second GCR Year until April 1, 2011." Tr 2, p. 322. He states that "Consumers has interpreted the Guidelines to mean that the 2012-2013 GCR year becomes the Second GCR Year at the end of February 2011, when the gas futures contract for March 2011 stops trading on the NYMEX and April 2011 becomes the prompt month." Tr 2, p. 325. Mr. Miller "see[s] no logical reason for the Commission to adopt or endorse this interpretation." Tr 2, p. 325. Mr. Miller notes that the current GCR year ends March 31, 2011, and states that the "following (2011-2012) GCR year should not be deemed to be the 'Current GCR Year' under the Quartile Triggers Guideline until it becomes the current GCR year (in common parlance) on April 1, 2011." Tr 2, p. 325.

Operational Planning

At Tr 2, pp. 327-28, after stating that he has "devoted considerable effort and attention to operational planning issues in Consumers' GCR plan and GCR reconciliation proceedings in the past few years', Mr. Miller identifies five "problems and concerns:"

> • The normal weather GCR operating plan in Exhibit A-23 may not be properly designed as a guide for helping to achieve low gas supply costs.
> • Consumers operates its gas supply system in a way that is fundamentally different from and disconnected from the normal weather GCR operating plan in Exhibit A-23.
> • Consumers has not provided sufficient information about its objectives in planning and operating its gas supply system in response to actual—rather than normal—weather conditions. Information about the role and importance of cost minimization is especially lacking.
> • Consumers has not provided information about the way its Buy/Sell activity may affect its GCR operations, or about the way it prevents its Buy/Sell activities from having an adverse effect on its GCR operations or its GCR cost of gas.
> • Consumers' position in its recent GCR reconciliation proceedings verges on the contention that the normal weather GCR operating plan (Exhibit A-23 in this year's GCR plan) is essentially irrelevant to an evaluation of the Company's operating decisions in its GCR reconciliation proceedings.

Mr. Miller recommends the formation of an "informal collaborative . . . to gain a better understanding of Consumers' operational planning" and to "consider ways that the planning process might be improved." Tr 2, p. 328. With regard to Buy/Sell activities, Mr. Miller recommends that the Commission "direct Consumers to include in its next GCR plan a discussion of the way it plans and manages its Buy/Sell activities, and [the] way those activities affect its GCR plans and GCR operations." Tr 2, p. 329. To justify this recommendation, he adds, at Tr 2, p. 329 that:

> In the past, these Buy/Sell activities appear to have been treated as outside the scope of Consumers' GCR proceedings. Now, however, Consumers has confirmed that its Buy/Sell activities do affect its GCR planning process, and clearly these Buy/Sell activities are under the direct control of Consumers' management. The Company should therefore be required to explain how its Buy/Sell decisions affect its GCR plans and the GCR cost of gas.

<u>Residential Ratepayers Consortium</u>

The RRC presented the testimony of Frank J. Hollewa, an independent energy consultant, dba Energy Planning and Engineering Consultants. Through Mr. Hollewa, the RRC presented evidence on three subjects: Consumers' fixed price purchasing policies and the results of those policies over the past four years, Consumers' gas allocations for the winter months, and Consumers' response to the Commissions' suggestion that Consumers may wish to present refinements to its purchasing methods in a future GCR Plan proceeding.

<u>Gas Purchasing Guidelines</u>

Mr. Hollewa, "shows the increased cost of supply from the [fixed price purchasing (FPP)] programs compared to purchases at monthly index", which, for Consumers, totals $752 million for the 2006-07 through 2009-10 GCR years. Tr 2, p. 369. Mr. Hollewa then states his opinion that, "[i]n light of this data, the only justification for continuing any FPP program is the claim . . . that price stability is a more important consideration." Tr 2, p. 369. In Exhibit RRC-1, Mr. Hollewa compares various NYMEX projections against NYMEX actuals and concludes that there exists "an upward price bias (or optimistic expectation that natural gas prices will always increase in the future)." Tr 2, p. 371.

In Exhibit RRC-2, Mr. Hollewa compares the actual NYMEX close to the actual monthly GCR factors for each month of the last four GCR years. He shows that Consumers' billed GCR Factors exceeded the actual NYMEX Close in 41 of 48 months. Tr 2, p. 371.

Referring to it as "a marked difference between the high and the low GCR Factors billed during the GCR period", Mr. Hollewa establishes that the difference between the high and low GCR factors was $1.44 in the 2006-07 GCR Year, $.80 in the 2007-08 GCR Year, $1.52 in the 2008-09 GCR Year, and $.18 in the 2009-2010 GCR Year. Tr 2, p. 372.

In Exhibit RRC-3, Mr. Hollewa compares the citygate cost of gas to Consumers' actual GCR factor over the same period.. Mr. Hollewa establishes that the monthly GCR Factors were higher than the citygate price in 40 of 48 months. Tr 2, p. 372. Additionally, he shows that the average citygate price was lower than the average GCR Factor by $1.45/Mcf in 2006-2007, $0.40/Mcf in 2007-2008, $0.03/Mcf in 2008-2009 and $2.98/Mcf in 2009-2010. Tr 2, p. 372.

As a result of his analysis, Mr. Hollewa makes three conclusions. First, because of the upward price bias, Consumers' FPP resulted in approximately $750 million in additional costs to customers. He finds no evidence to suggest this bias will change in the future. Next, he finds that his analysis "demonstrates the futility of the FPP Program as a means of securing price stability. The very stable range of $0.18 (high GCR Factor of $7.41 minus low GCR Factor of $7.23) attained in the 2009-2010 GCR Year could have been slightly less stable without FPP, but purchasing supply at Index would have resulted in a GCR Factor that was 40% lower." Finally, it's his opinion that "because the data demonstrates the FPP Program is not cost effective and that it does not achieve price stability, the main purpose served by the FPP is that it mitigates the possibility of any very large underrecovery associated with price volatility." Tr 2, p. 375.

Mr. Hollewa recommends that all fixed price purchasing be discontinued with, as explained at Tr 2, pp. 376-377, two following exceptions:

> 1. The Company may fix the price for up to 50% of the estimated volumes scheduled to be purchased in September and October 2010 at any time during June through August for September or June through September for October. Any FPP between 0% to 50% would be at the Company's option in its GCR Plan as it relates to quantity and method used to make such purchases. . . . Current commitments for September and October 2010 that already exceed 50% would delay this exception until existing purchase commitments fall below the 50% level.
>
> 2. The Company may fix the price for up to 50% of the estimated volumes scheduled to be purchased in the November 2010 through March 2011 winter season at any time during April through October if the average strip price is $5.00 or less. . . . Current commitments for the winter season that already exceed 50% would delay this exception until existing purchase commitments fell below the 50% level. . . . [T]he average winter strip price target [should] be reset to $5.50 or less to be effective on the First Trading Day (FTD) for the 2011-2012 GCR Year pending any adjustments in the GCR Plan Case for 2011-2012.

To ensure Consumers' ability to secure firm supply, Mr. Hollewa, recommends, at Tr 2, p. 377:

> 1. Long term contracts for a year or more priced at Index plus or minus (usually a penny or two) for the applicable production area.
>
> 2. Seven-Month contracts for the summer period based on NYMEX Close plus or minus a Fixed Basis adjustment for the applicable production area.

3. Five-Month contracts for the winter period based on NYMEX Close plus or minus a Fixed Basis adjustment for the applicable production area.

4. Monthly purchases at the FOM Index plus or minus.

5. Monthly purchases at the NYMEX Close plus or minus a Bid Basis adjustment.

6. Fixed Price Purchases as detailed above . . . .

All of the above methods will result in secure firm supply with contractual obligations that are no different from the purchase of fixed price supply. My recommendation is to use Index, but the NYMEX Close plus or minus the Basis adjustment would be permitted for up to 50% of purchases. However, the use of a fixed Basis in conjunction with NYMEX Close is limited to a maximum of seven months for the summer period and five months for the winter period in the current GCR Year only.

Contingency Mechanism

For a contingency mechanism, the RRC recommends the following, at Tr 2, pp. 378-379:

1. The Company may increase the filed GCR Factor by any amount up to $0.50 if the NYMEX Futures Strip in any month for the First Quarter of the GCR Year shows higher gas prices than those contained in the filed GCR Plan.

2. If the GCR Factor was not increased in the First Quarter, the Company may increase the Filed GCR Factor by any amount up to $0.50 if the actual NYMEX Close for the first 3 months plus the NYMEX Futures Strip in any month for the Second Quarter of the GCR Year, shows higher gas prices than those contained in the filed GCR Plan.

However, if the cumulative increase in the First and Second Quarters exceeds $0.50 and/or market volatility shows that an increase of up to $1.00 is necessary in the Second Quarter alone, then the Company may increase the Filed GCR Factor by any amount up to $1.00 in the Second Quarter. The maximum increase to the Filed GCR Factor is limited to $1.00 in the Second Quarter.

3. The Third Quarter review made in any month would follow the same process as the Second Quarter review except the cumulative increase would be raised to $0.75 and market volatility would be raised to $1.50. The maximum increase to the Third Quarter GCR Factor is limited to $0.75 and the maximum increase to the Filed GCR Factor is limited to $1.75 overall for the first three quarters.

4. The Fourth Quarter review made in any month would raise the cumulative increase to $1.00 and market volatility to $2.00. The maximum increase to the Fourth Quarter GCR Factor is limited to $0.75 and the

> maximum increase to the Filed GCR Factor is limited to $2.50 overall for the GCR Year.
>
> For every one of these contingent increases, the Company must supply supporting documentation to the Commission and all parties to the GCR Plan Case.

Gas Allocations

At Tr 2, pp. 383-86, Mr. Hollewa explains his discovery of errors in Consumers' 2010-11 GCR year gas allocations for the five winter months and his attempts to have Consumers address the error. Ultimately, using Consumers' data, Mr. Hollewa recommends using an 11-year average to make monthly allocations of gas sales. Tr 2, p. 387.

Late Season Purchasing

Finally, at Tr 2, pp. 389-90, Mr. Hollewa explains his conclusion that Consumers "does not plan to address the late-season purchasing issue . . . referenced by the Commission's Order in Case No. U-15041-R." As a result, Mr. Hollewa recommends that the Commission find that the Consumers' late-season purchasing plan is not reasonable and prudent and that it should not be approved. Tr 2, p. 390.

POSITIONS OF THE PARTIES

Overview

Consumers argues for adoption of its GCR Plan, as filed, with two modifications. First, Consumers supports Staff's recommendation that the Commission approve the same Gas Purchasing Strategy Guidelines as were approved in Case No. U-15704. Second, Consumers supports adoption of Staff's proposed contingency mechanism for the 2010-2011 GCR year, "on an experimental basis". In the alternative, should Staff's proposal not be adopted, Consumers supports its mechanism, as proposed. Consumers Initial Brief, p. 1.

Thus for relief Consumers requests, at Consumers Initial Brief, p. 2, that the Commission:

> (i) Find that the gas supply plan filed by Consumers Energy for the 2010-2011 GCR year is reasonable and in the public interest and approve the Company's gas supply plan;
> (ii) Find that the Gas Purchasing Strategy Guidelines that were approved by the Commission in its March 2, 2010 Order in GCR Plan Case No. U-15704 should be approved also in GCR Plan Case No.U-16149;
> (iii) Approve the Staff proposed maximum GCR factor for the 12-month period of $7.8217 per Mcf . . .;
> (iv) Find that there are no cost items in Consumers Energy's five-year forecast of gas requirements, supplies and costs that, on the basis of present evidence, the Commission would be unlikely to permit Consumers Energy to recover in the future; and
> (v) Grant Consumers Energy such other and further relief as is just and reasonable.

Staff recommends Commission approval of Consumers' proposed 2010-2011 GCR plan, with two revisions. First, Staff recommends continued use of the fixed price purchasing guidelines that were approved in U-15704. Second, Staff proposes a "simplified Contingent Factor Mechanism" based on a levelized fractional multiplier of 0.3313 and a $2.50 per Mcf contingency adjustment cap.

The RRC addresses and recommends changes to Consumers' fixed price purchasing program, its contingency mechanism, its winter sales estimates, and its late season purchasing strategy. In addition, at RRC Initial Brief, p. 16, RRC requests that the Commission:

> 1. Issue a warning under MCL 460.6h(7) that it is unlikely on the basis of present evidence to permit Consumers Energy Company to recover from its customers in GCR factors established in the future, the excess gas costs caused by new purchases made under the Company's fixed price purchasing program in future GCR Plan periods.

* * *

> 5. Find that Consumers has not justified the late-season purchasing plan in its 2010-2011 GCR and order that part of the Company's 2010-2011 GCR Plan is not approved.

The Attorney General recommends continuation of the current contingency mechanism, with, apparently, one slight change. Additionally, the Attorney General recommends that the Commission limit the existing purchasing guidelines until a "collaborative can be convened to discuss the impact of fixed price purchasing". AG Initial Brief, p. 15.

Legal and Regulatory Actions

Consumers notes its presented evidence on its "policy to participate in any proceeding that may have a material impact on the costs of gas or the availability of natural gas interstate transportation necessary to meet the needs of [its] customers" and that no party filed testimony in opposition. Consumers Initial Brief, p. 9.

Sales Forecast

Generally

Consumers argues that its sales forecasting is reasonable. Consumers notes that it presented sales and transportation forecasts through March 2015. Consumers Initial Brief, p. 13. Consumers states that the four major classes of gas deliveries forecasted are residential, commercial, industrial, and interdepartmental. Consumers Initial Brief, p. 13. "Three primary methodologies were used to forecast gas deliveries: . . . regression analysis . . ., exponential smoothing . . . ., and professional judgment. . . . Professional judgment was used to forecast residential space heating customers and interdepartmental deliveries." Consumers Initial Brief, p. 13. "[T]he Company's base gas sales and transportation forecast is a weather normalized forecast, based on the assumption that normal weather will occur during the forecast period. The normal level of heating degree days used to forecast gas deliveries in the forecast models was developed by taking an average of the most recent 15 years of historical heating degree days." Consumers Initial Brief, p. 13.

Five-Year Forecast

Consumers notes that its five-year forecast was presented by its witness, Mr. Howard. As stated, at Consumers Initial Brief, p. 53:

> [Consumers] anticipates continuing to follow the strategy as set forth in the Gas Purchasing Strategy Guidelines and discussed in his testimony as the basic strategy. 2 TR 159. Consumers Energy requests that the Commission find that there are no cost items in Consumers Energy's five-year forecast of gas requirements, supplies, and costs that, on the basis of present evidence, the Commission would be unlikely to permit Consumers Energy to recover from customers in the future.

Winter Gas Sales Estimates

RCC points out "a major inconsistency" in Consumers' estimated monthly gas sales. RRC Initial Brief, pp. 11-12. In Exhibit RRC-7, the RRC "shows the monthly allocation factors for each of the five winter months for each of the 11 years of data provided by [Consumers]", the "calculations for the 2-year average through 11-year average for each month", and "the 2010-2011 factors used by [Consumers]". RRC Initial Brief, p. 13. At RRC Initial Brief, p. 13, the RRC recites the following observations:

> • The Company's January Factor of 0.175019 is lower than all averages and all individual years.
> • The Company's February Factor of 0.158354 is higher than all averages and all years except 2003.

• The Company's March Factor of 0.136648 is higher than all averages and all years except 2004 and 2007.
• The Company's November Factor of 0.106987 is reasonable.
• The Company's December Factor of 0.172015 is higher than all averages and all individual years.
• The Company's 5-Month Factor of 0.749023 is higher than all averages and all individual years.

The RRC adds, at RRC Reply Brief, pp. 5-6:

> Consumers does not explain why there is a major inconsistency in Exhibit A-2 with the way the Company has presented this information (the Company's estimate of annual and monthly gas sales) in past GCR cases. Exhibit RRC-6 contains discovery responses from Consumers that show the Company was unable to provide credible explanations for its estimates.
>
> Exhibit RRC-7 . . . show[s] the monthly allocation factors for each of the five winter months for each of the 11 years of data provided by the Company. It also shows that the monthly allocation factors Consumers is proposing . . . deviate significantly from the preceding historical period which lead the RRC to conclude that the Company's monthly estimates in the five winter months need to be corrected. The "fix" described in the RRC's initial brief is based on an approach described by Consumers witness Clark in a discovery response to be applied to the Company's estimates for the five winter months in this case:
>
> > For comparison purposes, after a gas forecast is prepared using actual heating degree days and actual deliveries, the actual historical gas deliveries are weather normalized using the same 15-year normal that is used for the forecast years. This ensures that the historical and forecasted deliveries are consistent.
>
> Exhibit RRC-7 shows the monthly allocation factors that should be used instead of those used by the Company for the monthly distribution shown on Exhibit A-2 and A-3 for the November through March period.

At RRC Initial Brief, p. 14, RRC proposes adoption of the following monthly estimates based on the 11-year averages:

	11-Year Average	Gas Sales	2010-11 Factors	Exh. A-2 Gas Sales	Difference Gas Sales
Nov.	.10764	23,937	.10699	23,792	+ 145
Dec.	.15992	35,563	.17202	38,253	- 2,690
Jan.	.18362	40,834	.17502	38,721	+ 1,913
Feb.	.15513	34,498	.15835	35,215	- 717
Mar.	.13099	29,130	.13665	30,388	- 1,258
Total	.73729	163,962	.74902	166,569	- 2,607

Consumers is critical of the RRC's recommendations. In part, the criticism stems from the RRC's use of Consumers' originally filed figures, which have been updated and corrected. Consumers Reply Brief, p. 19.

After acknowledging, but failing to identify, the calculation error in its monthly allocation percentages, Consumers proposes to allocate updated sales figures "using a four-year historical average rather than the methodology used . . . in the initial filing." Consumers Initial Brief, pp. 14-15. Consumers argues that allocations based on an four-year average are more accurate than the RRC's allocations, based on an 11-year average. Consumers claims that since hurricanes Katrina and Rita, in 2005, there has been "structural change" in its sales and that use of a four-year average better captures it. Consumers Reply Brief, p. 19.

Gas Purchasing Strategy Guidelines

Consumers believes the Commission should adopt the same gas purchasing guidelines as it approved in Case No. U-15704. Consumers Initial Brief, p. 17. Thus, Consumers proposes to continue use of its tiered fixed price purchasing and quartile fixed price trigger purchasing mechanisms.

With regard to tiered purchases, Consumers states, at Consumers Initial Brief, pp. 18-19:

> [T]he Tiered Fixed Price Purchase Guideline uses a tiered approach that requires the price be fixed on certain minimum percentages of annual supply requirements at specific points in time. The tiered fixed price purchases guideline requires that at least 15% to 20% of the gas requirement for a GCR period be under fixed price contracts by December 1st of the preceding period, at least 25% to 30% by the following April 1st, at least 35% to 40% of winter requirements (Nov – Mar) by July 1st of the Plan year, and at least 50% of winter requirements by October 15th of the Plan year. 2 TR 142. Mr. Howard testified that this purchase pattern guideline is reasonable and is consistent with the goal of securing reliable supplies at reasonable price levels. 2 Tr 142.

With regard to quartile purchases, at Consumers Initial Brief, p. 19, Consumers states:

> The Quartile Fixed Price Trigger Guideline provides a method of fixing the price on a portion of supply if current market prices are within or below certain historical price ranges or quartiles. 2 TR 144. Consumers . . . requests that the Commission approve the same Quartile Fixed Price Percentages that were approved by the Commission in Case No. U-15704.

Staff supports Consumers' proposal to continue use of the guidelines and adds that, in its next GCR plan case, Consumers should present "revised gas purchasing guidelines based on the Company's expertise and knowledge of its system operations." Staff Initial Brief, p. 3.

The RRC argues against Consumers' proposal and highlights the fact that, since the 2006-07 GCR year, when compared to purchases at index, fixed price purchasing (FFP) has resulted in additional gas costs of $752.05 million. RRC Initial Brief, pp. 1-2. The RRC claims that Consumers "ignores . . . the evidence . . . that shows that $752 million in excess costs have been caused by [Consumers'] fixed price purchasing strategy over the past four years" and argues that "[s]addling the GCR customers with GCR factors that far exceed the market price for natural gas is unreasonable and imprudent . . . ." RRC Reply Brief, pp. 2-3. The RRC contends that its data supports the conclusion that there exists "an upward bias" or "expectation that natural gas prices will always increase in the future". RRC Initial Brief, p. 4. Further, the RRC argues that FPP fails to provide price stability and notes that the difference between the high and low GCR factors billed per GCR period varied by 1.44 in 2006-07, 0.80 in 2007-08, 1.52 in 2008-09, and 0.18 in 2009-19. RRC Initial Brief, p. 4. Based on these observations, the "RRC takes the position . . . that the Commission should not approve an FPP program for Consumers . . . on a going forward basis." RRC Initial Brief, p. 6.

Additionally, at RRC Initial Brief, pp. 6-7, RRC further recommends that:

> [T]he Commission issue a warning under MCL 460.6h(7) that it is unlikely on the basis of present evidence to permit Consumers . . . to recover . . . the excess gas costs caused by new purchases made under the Company's fixed price purchasing program in future GCR Plan periods [and] . . . that in the 2010-2011 GCR Plan year, all fixed price purchases be discontinued with the following two exceptions:
>
> 1. The Company may fix the price for up to 50% of the estimated volumes scheduled to be purchased in September and October 2010 at any time during June through August for September or June through September for October. Any FPP between 0% to 50% would be at the Company's option in its GCR Plan as it relates to quantity and method used to make such purchases. . . .
>
> * * *
>
> 2. The Company may fix the price for up to 50% of the estimated volumes scheduled to be purchased in the November 2010 through March 2011 winter season at any time during April through October if the average strip price is $5.00 or less.

The RRC argues that Consumers has several options to secure firm supply and recommends, at RCC Initial Brief, pp. 7-8, that Consumers utilize the following strategies:

> 1. Long term contracts for a year or more priced at Index plus or minus (usually a penny or two) for the applicable production area.
>
> 2. Seven-Month contracts for the summer period based on NYMEX Close plus or minus a Fixed Basis adjustment for the applicable production area.

> 3. Five-Month contracts for the winter period based on NYMEX Close plus or minus a Fixed Basis adjustment for the applicable production area.
>
> 4. Monthly purchases at the FOM Index plus or minus.
>
> 5. Monthly purchases at the NYMEX Close plus or minus a Bid Basis adjustment.
>
> 6. Fixed Price Purchases as detailed above . . . .
>
> All of the above methods will result in secure firm supply with contractual obligations **that are no different from the purchase of fixed price supply**.

At RRC Initial Brief, pp. 8-9, the RRC adds:

> It is the RRC's position that . . . Consumers' proposal to continue using fixed price purchasing to secure up to 90% of its annual requirements is unreasonable and imprudent. It will do nothing more than lock in losses for the GCR customers. The RRC's analysis in this case demonstrates that making gas purchases by fixing prices has resulted in higher GCR costs . . . than what would have been achieved if the Company had instead purchased its GCR supply at Index. The data in Exhibit RRC-1 demonstrates the existence of an upward price bias where the NYMEX Actual was lower than the NYMEX Projection in 31 out of 38 periods. There is no evidence to suggest that this relationship will change in the future.
>
> * * *
>
> The data demonstrates that making gas purchases by fixing prices is not cost effective and it does not achieve price stability. The only other purpose served by a FPP Program is that it mitigates the possibility of the utility incurring a very large underrecovery associated with price volatility. There are better ways to address that potential problem.

Staff opposes the RRC's recommendation that the Commission issue a warning that it is unlikely to allow Consumers "to recover its excess gas costs under [Consumers'] fixed price purchasing program in place for future GCR plan years." Staff Reply Brief, p. 5. At Staff Reply Brief, p. 6, Staff adds:

> A review of the evidence does not demonstrate that a warning is necessary. The Commission approved Consumers Energy's purchasing guidelines in its 2009-2010 GCR plan proceeding for the current and future GCR plan years. In Case No. U-15704, when reviewing the Company's purchasing guidelines, the RRC alleged that the Company's "current fixed price purchasing guidelines have resulted in substantially increased costs for ratepayers." The Commission rejected the guideline changes

> recommended by the RRC. As the Commission previously looked at alternatives presented by the RRC and chose to implement the guidelines currently in place, Staff opposes the issuance of a warning and supports the continuation of the guidelines as amended in Case No. U-15704. For future plan years, . . . Consumers Energy should "…take the initiative and provide its version of gas purchasing guidelines based on its expertise and knowledge of its system operations." 2 TR 453. This would have the Company assume greater responsibility over its gas purchasing practices.

The Attorney General opposes continuation of the current gas purchasing guidelines. For the Attorney General, continuing the current policy "ignores the unrefuted evidence . . . that demonstrates implementing fixed-price guidelines has increased GCR costs for CECo's customers by hundreds of millions of dollars over the past several years". AG Reply Brief, p. 5. The Attorney General continues, at AG Reply Brief, p. 6, by stating:

> [I]t is no longer just and reasonable to simply maintain the same guidelines. The Commission should . . . cap the quantity of Second Quartile purchases for . . . the Third GCR Year . . . at 20% of Consumers' projected total requirements for the Third GCR Year . . . [and] clarify that the 2012-2013 GCR year will remain the Third GCR Year through March 31, 2011, and that it will not become the Second GCR Year until April 1, 2011 . . . .

Additionally, in response to Consumers claim that the guidelines reduce price volatility and risk, the Attorney General adds, at AG Reply Brief, p. 10:

> [T]he party avoiding risk is the utility by relying solely upon a formula that has proved to be unsuccessful. MCL 460.6h does not state that price volatility is unjust or unreasonable, but a utility has a duty to minimize the cost of gas. If reducing volatility results in higher costs in total, then reducing volatility comes at a very high price for ratepayers, and the Commission should not approve a plan simply because it reduces price volatility.
>
> CECo argues that a fixed-price purchasing plan provide[s] a disciplined approach in an uncertain and volatile market (Brief, p 22). This is simply a restatement of CECo's position that fixed price purchases made well-ahead of the contract delivery dates will be known in advance and will be stable. . . . [F]ixed price [purchases] have not succeeded in accomplishing anything more than stability and avoiding risks for CECo.

Consumers takes issue with the Attorney General's and RRC's proposals. Consumers Initial Brief, pp. 21-24. Consumers argues that their observations that alternative purchasing strategies would have saved money in past years can not provide assurance of future savings. Consumers Initial Brief, p. 21. Further, Consumers argues that its Guidelines are not solely a means to minimize cost, but also serve to mitigate price volatility and risk. Consumers Initial Brief, pp. 21-22. Consumers points to uncertainty to support its purchasing strategies, by stating at Consumers Initial Brief, p. 23 (citations omitted):

> [N]o one can determine at the time of a purchase if a future market price of gas will be higher or lower than the then current market price of gas. *<u>At each point in time that a fixed price purchase is entered into under the Gas Purchasing Strategy Guidelines, it is executed at a price reflecting the current market price of natural gas for the purchase period</u>*.
>
> Mr. Howard testified:
>
> > Since the future prices cannot be known with certainty, it is appropriate to have a disciplined purchasing strategy as opposed to exposing the customer to the risk of volatility and uncertain outcomes.
>
> . . . NYMEX natural gas prices in the recent past have been, in general, declining. Prices clearly cannot decline indefinitely. It is not known when prices will begin increasing.

At Consumers Reply Brief, pp. 3-4, Consumers argues:

> [T]he RRC and the Attorney General: (i) have misconstrued the purpose of including Fixed Price Purchase provisions in the Guidelines, and (ii) have not shown that historical price trends can, or should, be used to predict future price trends or results.
>
> The . . . Guidelines seek to balance supply and price issues in a way that helps provide assurance of supply, reduces volatility, stabilizes prices, and increases purchases as the winter heating season approaches or if the market price varies outside of preset parameters. As costs decrease, the Guidelines provide for increased fixed price purchases. The Fixed Price Purchase provisions are consistent with the goal of providing reliable supplies at reasonable prices and provide a reasonable approach to gas purchasing. While MCL 460.6h(6) lists cost as a consideration, it does not use the term "cost minimization." There are considerations

related to cost other than keeping costs as low as possible. In addition, cost is only one of a number of considerations identified in MCL 460.6h(6).

Consumers adds, at Consumers Reply Brief, p. 5:

> The price for *__all__* purchased gas will become fixed at some point in time. The issue is one of timing ─ whether to let the price become fixed through settlement of the NYMEX market price immediately before the purchase period begins or to lock in the price prior to that point in time through purchasing it as a Fixed Price Purchase. Any time that Consumers Energy purchases gas at a fixed price or allows an index price to "settle" it is purchasing gas at the then-current market price of the gas.
>
> * * *
>
> Since the future prices cannot be known with certainty, it is appropriate to have a disciplined purchasing strategy as opposed to exposing customers to the risk of volatility and uncertain outcomes.

Consumers continues by rebutting RRC's argument that fixed price purchases do not provide price stabilization by arguing that with fixed price purchasing "there will likely be some variation," but that "in a volatile market that variation is likely to be less than would occur from gambling on the index price. . . . Buying all . . . , or the majority of natural gas, at index prices would put customers at risk for price spikes caused by hurricanes, cold weather, or other events." Consumers Reply Brief, p. 6. Consumers claims that RRC's analysis reflects "invalid and inconclusive comparisons and calculations." Consumers Reply Brief, pp. 6-8.

__Multi-Utility Collaborative__

The Attorney General believes the Commission should "limit the prior guidelines until a collaborative can be convened to discuss the impact of fixed price purchasing guideline(s)". AG Initial Brief, p. 15. The Attorney General adds that "[o]perating a natural gas distribution utility and providing transmission services and gas supply is a very sophisticated and complex process that requires many planning adjustments during a GCR year. The Commission should institute further proceedings to investigate these issues." AG Initial Brief, p. 15.

Consumers rejects the Attorney General's proposal to suspend the operation of the guidelines and states, at Consumers Initial Brief, p. 26:

> If a collaborative effort does occur on an individual utility basis or on a multi-utility basis, then any consensus conclusions could be addressed in the context of future utility-specific GCR Plan cases. The Gas Purchasing Strategy Guidelines in the current case should not be restricted based on the possibility that some alternative approach might occur at some point in the future. The possibility of a consensus developing at a future point in time does not warrant restricting review and approval of the guidelines proposed in this case.
>
> . . . The Guidelines provide a framework for a long-term strategy and should remain in place unless and until changed or superseded in the context of a statutorily defined GCR Plan case.

Consumers adds that "[t]he appropriate and lawful forum for evaluating Consumers Energy's gas purchasing strategies is in this GCR Plan case and future . . . cases, consistent with the statutory framework of MCL 460.6h." Consumers Reply Brief, p. 9.

Staff takes no position on whether the Attorney General's recommendations regarding collaboratives should be ordered, but recommends that, if they are ordered, they be between Consumers and interested parties and that they not include all natural gas utilities. Staff Reply Brief, pp. 4-5.

<u>Modeling Process</u>

Through use of its proprietary software program, Sendout, Consumers "uses a sequential modeling technique to develop a normal weather plan that provides sufficient cold weather reserve in storage to protect for an early, middle, or late season design cold winter". Consumers Initial Brief, p. 33. "Inputs include storage field performance characteristics by field and/or field group, the piping constraints, and compression constraints that impact storage volumes to and from the system." Consumers Initial Brief, p. 34. "Consumers Energy evaluates storage field and system operation under six different weather scenarios as part of its initial GCR year planning process." Consumers Initial Brief, p. 34. "The GCR purchase requirements for the winter months in each scenario are established at a level that is sufficient to meet the GCR monthly demands and the peak day demands for the entire system, within the constraints of the physical system." Consumers Initial Brief, p. 35. Consumers "seeks to optimize its storage field utilization throughout the Plan year, but particularly during the winter season in an effort to minimize the cost of gas to its GCR customers." Consumers Initial Brief, p. 35.

> The results of this rigorous review are used for the initial planning. During the GCR year, [Consumers] continues to evaluate its customers' supply needs based on current and projected market and operational conditions. Among the factors considered are changes in weather, Gas Customer Choice volumes, customer usage, and system constraints, including the ability to inject and withdraw gas from storage fields. Consumers . . . GCR Plan contemplates reviews will occur during the GCR year and adjustments, if appropriate, will be made using the methodologies contemplated in the Plan.
>
> Decisions whether to buy incremental supplies during the winter are based on the most current information then available. Ms. Harvey testified:
>
> > The decision whether to buy incremental supplies is accomplished in two steps. Each month during the first eight work days a new monthly GCR purchase and cost of gas supply forecast is developed incorporating the previous month's actual data, an updated price forecast and inventory guidelines from the normal and design cold plan case. This analysis is then reviewed starting at mid-month incorporating actual non-GCR customer storage and supply activity during the first part of the month, current individual storage field inventories, forecasted storage capability, estimates of weather for the remaining part of the month, operational changes occurring on the system, peak day requirements and a 4% probability of CTN weather design for the

> remainder of the winter months. As result of this updated analysis decisions are made on incremental purchases. This methodology ensures that the purchase decision is based on the most current information available.
>
> The purchase decision for a month is generally made approximately 1 to 2 weeks before the start of the month.
>
> The detailed process . . . provides a reasonable planning basis both at the beginning and then during the Plan year. The approach . . . is reasonable and prudent and helps minimize the chances of supply disruption for . . . customers. Consumers Initial Brief, pp. 35-36.

Peak Day and Winter Requirements

Consumers states that its "planning methodology for [CTN] weather is consistent with the methodology . . . used in prior GCR years. That methodology has worked well, has a proven track record, and its use continues to be appropriate for the current GCR year." Consumers Initial Brief, p. 27.

For design planning, Consumers uses a 4% probability of a CTN winter and an 80 heating degree day assumption for January peak requirements. Consumers Initial Brief, p. 27.

Exhibit A-28 shows Consumers calculations for peak day requirements. Consumers uses an 80 heating degree day assumption for the January peak day, 65 for February, and 50 for March. Storage provides up to 80% of the supply to meet peak day requirements. Consumers Initial Brief, p. 31. Consumers' natural gas storage fields provide approximately 60% of the winter supply. Consumers Initial Brief, p. 31. Of those fields, nine are base load and six are peak. Consumers Initial Brief, p. 31.

Late Season Purchasing

The RRC states, at RRC Initial Brief, pp. 15-16 that:

On page 10 of its December 16, 2009 Order on [*sic*] Case No. U-15041-R, . . . the Commission said:

> The Commission agrees that there appears to be some evidence that the company's late-season purchasing strategy could be improved. Consumers may wish to present a refinement to its purchasing methods in a future GCR plan proceeding. Intervenors in future GCR plan cases are also encouraged to analyze past results and provide recommendations for alternative strategies for Commission consideration.

RRC argues, at RRC Reply Brief, pp. 6-7:

> Despite the Commission's expression in its December 16, 2009 Order in Case No. U-15041-R that CECo should pursue this goal, the Company's position is that what it is doing is good enough.
>
> The ALJ and the Commission are urged to review the full argument on this issue presented on pages 15-16 of the RRC's initial brief. Based on the evidence in this case, the ALJ and the Commission should conclude that there is no evidence that Consumers is actively exploring ways to improve its late season purchasing practices for the benefit of its GCR customers. That posture is unreasonable and imprudent and the Commission should find that the utility has not justified its late-season purchasing plan and order that part of the Company's 2010-2011 GCR Plan is not approved.

Consumers takes issue with criticism from the RRC's witness, Mr. Hollewa. Consumers contends that "Mr. Hollewa has not presented any evidence or argument . . . that would provide a valid basis for finding that [Consumers] late season purchasing strategy is not reasonable and prudent." Consumers Initial Brief, pp. 36-37. Consumers "has considered alternative approaches that Mr. Hollewa has made and has concluded that they either increased customer risk or were not operationally sound. Consumers Initial Brief, p. 37.

<u>Buy/Sell Activity</u>

In regard to buy/sell activity, the Attorney General argues, at AG Reply Brief, pp. 12-13, that:

Since the FERC approved open access pipeline service and capacity releases via a bulletin-board system, CECo's buy/sell activities are a part of pipeline charges and credits, which must be treated as a part of the GCR recovery system just like previous minimum-bill charges were treated. *Attorney General v PSC,* 171 Mich App 696; 431 NW2d 47 (1988).

Consumers argues that [t]here is no record evidence supporting the . . . Attorney General's [proposal] . . . that the Commission direct Consumers . . . to address this subject . . . in a future GCR Plan case." Consumers Initial Brief, p. 40. Consumers adds that "[b]uy/sell activity revenues are treated as miscellaneous revenues in general rate cases. . . . [B]uy/sell transactions are scheduled around the planned GCR/GCC storage activity within the system capacities and constraints so that there will be no negative impact on GCR customers. Consumers Initial Brief, p. 39.

Contingency Mechanism

Staff has proposed a newly designed contingency mechanism and, at Staff Initial Brief, p. 5, explains:

> Under Staff's modified Contingent Factor Mechanism, the Company's proposed base factor of $6.9934 per Mcf would be approved along with the Maximum Allowed GCR Factor Adjustment of up to an additional $0.8283 per Mcf.[10] By establishing a Maximum Allowed GCR Factor Adjustment, Consumers Energy would have greater billing flexibility and could adjust the base GCR factor according, up to the adjustment's maximum, based on future events outside of the Company's control. 2 TR 451. . . . [T]his modification would simplify the Company's proposed Contingency Mechanism because it does not require a NYMEX comparison, is easier to understand and administer, has the potential of decreasing the Company's under- and over- recoveries, and provides GCR customers with more certainty in the amount billed. 2 TR 450.
>
> [10] The difference between Consumers Energy's requested base factor of $6.9934 per Mcf and Staff's maximum allowed GCR factor adjustment of $7.8217 per Mcf:

$$\text{The Maximum Allowed GCR Factor Adjustment} = \left(\begin{matrix}\text{Consumers Energy's} \\ \text{requested base factor}\end{matrix}\right) + \left(\left(\begin{matrix}\text{levelized fractional} \\ \text{multiplier}\end{matrix}\right) * \left(\begin{matrix}\text{contingency adjustment} \\ \text{cap}\end{matrix}\right)\right)$$

$$= \left(\frac{\$6.9934}{\text{Mcf}}\right) + \left((0.3313) * \left(\frac{\$2.50}{\text{Mcf}}\right)\right)$$

$$= \left(\frac{\$7.8217}{\text{Mcf}}\right)$$

To justify its proposal, Staff states, at Staff Initial Brief, pp. 6-7:

> Staff recognizes that the current Contingent Factor Mechanism is limited to increases in the market price of natural gas. However, Act 304 can encompass the occurrence of other contingent events and not require a specific 'trigger'. Section 460.6h(6) states:
>
> > In evaluating the decisions underlying the gas cost recovery plan, the commission shall consider the volume, cost, and reliability of the major alternative gas supplies available to the utility; the cost of alternative fuels available to some or all of the utility's customers; the availability of gas in storage; the ability of the utility to reduce or to eliminate any sales to out-of-state customers; whether the utility has taken all appropriate legal and regulatory actions to minimize the cost of purchased gas; and other relevant factors.
>
> Review of Consumers Energy's 2010-2011 GCR plan shows that the Company considers a number of variables when constructing its GCR plan and requested base GCR factor of $6.9934 per Mcf. These assumptions go beyond examining the market price of natural gas and one incorrect or deviation from the GCR plan's assumptions can change the GCR factor necessary to recover the cost of gas for a particular month during the 2010-2011 GCR year. The contingent nature of the GCR plan's assumptions or variables qualifies as 'other relevant factors' for the Commission's consideration. . . . Given the statute's interest provision, it is reasonable to conclude that a utility would not desire to overcollect from GCR customers the cost of natural gas. Thus, it is reasonable to allow Consumers Energy the flexibility each month to move within or below the requested base factor of $6.9934 per Mcf and up to the maximum allowed GCR factor adjustment of $7.8217 per Mcf . . . . [I]n the past, future events were identified as the change in market price of natural gas . . . . A review of the statute shows that it does not require a particular event to be identified, or even to have actually occurred, for the Commission to authorize a GCR factor that 'may include specific amounts contingent on future events'.

Consumers supports Staff's proposal. However, Consumers "believes that an adjustment amount higher than $2.50 per Mcf would be more representative of potential volatility." Consumers Initial Brief, p. 46. None-the-less, because of the "additional billing flexibility provided", Consumers accepts Staff's use of a fractional multiplier of 0.3313, a NYMEX adjustment cap of $2.50, and Consumers' base factor of $6.0034 per Mcf to arrive at the maximum factor of $7.8217 per Mcf. Consumers Initial Brief, pp. 45-46.

In support of this proposal, Consumers states that it "has no incentive to charge more than is necessary to recover its costs." Consumers Initial Brief, p. 40. "[I]t is Consumers' policy to set its monthly factors such that plan period revenues will match GCR Plan period booked cost of gas". Consumers Initial Brief, p. 41. Consumers "only charges the maximum factor . . . if . . . analysis . . . indicates that the maximum factor is needed to reach a zero under/over recovery of the GCR cost during the GCR year." Consumers Initial Brief, p. 41.

Consumers explains, at Consumers Initial Brief, pp. 42-44:

> The GCR factors . . . established in a GCR Plan case are ceiling factors. These factors represent the maximum amount that Consumers . . . can charge customers for . . . gas . . . .
>
> * * *
>
> Both the Staff contingency proposal and [Consumers'] . . . proposal are designed with the goal of providing Consumers . . . with the ability to adjust the charged GCR factor to reflect fluctuations that increase the cost of gas on a more real time basis without the need for, or inherent delay in, reopened proceedings to adjust the factor. In addition, allowing timely adjustments through use of the adjustment mechanism will help avoid deferring increases and putting added economic pressures on customers when the deferred costs are recovered.

Consumers adds that its "method for determining the monthly GCR billing factor . . . will not change [under] Staff's methodology . . . . The monthly GCR billing factors would continue to be established using this policy at the break-even level over the remaining period at the time of the analysis, but would not exceed the annual maximum allowed GCR factor." Consumers Initial Brief, p. 47

Finally, Consumers states that Staff's proposal "is consistent with Act 304 and with the goal of providing an opportunity for Consumers . . . to recover . . . GCR costs in a timely manner. It simplifies the approach while providing greater flexibility . . . to more quickly respond to any price changes in the NYMEX market." Consumers Initial Brief, p. 48.

The Attorney General opposes Staff's proposed contingency mechanism. The Attorney General argues that "a GCR factor must be based upon projected gas costs and is a maximum rate, not a floor or base." AG Reply Brief, p. 8. "Staff would not require a NYMEX comparison and . . . proposes to add an arbitrary $0.8283 per Mcf to CECo's $6.9934 in order to give CECo greater billing flexibility not contingent upon any specified 'future event.'" AG Reply Brief, p. 8. Staff's proposal simply increases [Consumers] proposed GCR factor before any future event must occur." AG Reply Brief, p. 9. The Attorney General concludes, at AG Reply Brief, p. 9:

> Staff argues that it is unreasonable to approve a plan where the cost of gas could rise and cause under recoveries (Brief, p 9). The Legislature provided two remedies related to that potential. First, MCL 460.6h(10) authorizes a utility to revise its GCR plan. Second MCL 460.6h(12)-(15) create a reconciliation process that provides for interest on over or under recoveries. In light of these statutes, the Legislature did not agree with the Staff's argument that it would be unreasonable to approve a plan where the cost of gas could rise and cause under recoveries. Since a GCR plan by its very nature involves projected costs, it always could result in over or under recoveries (2 Tr 336-37).

To counter the Attorney General's concern that the proposal is not cost based, Staff states that, in past cases, "proof of a possible [gas price increase] was not necessary for Commission [approval] of a contingency mechanism" and that "the possibility of an increase in the price of natural gas was sufficient reason for the Commission to approve the use of the Contingent Factor Mechanism." Staff Initial Brief, p. 8.

Staff argues that its mechanism is lawful and may "be based upon changes in any element that supports the requested factor." Staff Reply Brief, p. 2. At Staff Reply Brief, pp. 2-3, Staff points to MCL 460.6h(3) and MCL 460.6h(6) for support of its proposal and states:

> Review of a GCR plan shows there are a number of variables that produce the projections that ultimately result in a base GCR factor, and thus there are other events besides NYMEX price increases that may require an increase in the GCR factor. To calculate the requested GCR factor, the GCR plan assumes numerous things besides the market price of gas. One incorrect assumption can change the GCR factor necessary to recover GCR costs. Staff believes the nature of these variables within a given GCR plan would qualify as "other relevant factors" for the Commission to consider.

The RRC opposes Staff's contingency mechanism because it allows Consumers "to increase its GCR factor without any showing that, in fact, any particular contingency has occurred that justifies the increase. In effect, Staff's proposal . . . amounts to a blank check to increase the GCR factor without having to establish that the increase is needed to address any particular cost element in the Company's filed GCR Plan." RRC Reply Brief, p. 1.

The RRC points to the statutory provisions of MCL 460.6h(6) and states, at RRC Reply Brief, pp. 1-2, that:

> Staff identifies no specific 'future events' for which 'a specific amount' is justified. The rationale seems to be that anything can happen, and if it does, Consumers should have the flexibility to increase its GCR factor without any showing that the increase is needed or justified. Stated another way, Staff's proposal creates a 'fudge factor' in the GCR factor that is not cost justified and is not authorized by the governing statute.

In reply to the Attorney General and the RRC, Consumers argues that, while Staff's proposal maybe "different", that "does not make it unlawful." Consumers Reply Brief, p. 24.

If Staff's proposal is rejected, Consumers argues for adoption of its originally proposed contingency mechanism. As stated at, Consumers Initial Brief, p. 49:

> The key components of the Company's quarterly adjustment mechanism are: 1) the higher of the change in the entire 12 month GCR NYMEX price strip or the change in the remaining GCR NYMEX strip from the Plan NYMEX each quarter, 2) a $3.00 ceiling factor cap to the change in NYMEX prices, and 3) a levelized fractional multiplier of 0.394 or 39.4%. . . .
>
> In Case No. U-15704 the Commission approved use of the full 12-month NYMEX strip in the contingency calculation. Consumers Energy agrees that the full 12-month strip price should be used if a Quarterly Adjustment Mechanism approach is adopted in this case. However, Consumers Energy submits that modifying the calculation to use the higher of (i) the change in the entire NYMEX strip or (ii) the change in the remaining strip would help facilitate the timely recovery of recoverable GCR costs from customers, would help better match the timing of recovery with the timing of costs, and help minimize interest owed by customers.

The RRC, also, proposes a new contingency mechanism. "One of the [RRC's] goals . . . was to make a proposal that would mitigate the possibility of very large underrecoveries . . . during the GCR year while formulating a mechanism . . . which is relatively simple and easy to understand. At RRC Initial Brief, pp. 9-10, RRC proposes adoption of the following contingency mechanism:

> 1. The Company may increase the filed GCR Factor by any amount up to $0.50 if the NYMEX Futures Strip in any month for the First Quarter of the GCR Year shows higher gas prices than those contained in the filed GCR Plan.
>
> 2. If the GCR Factor was not increased in the First Quarter, the Company may increase the Filed GCR Factor by any amount up to $0.50 if the actual NYMEX Close for the first 3 months plus the NYMEX Futures

> Strip in any month for the Second Quarter of the GCR Year shows higher gas prices than those contained in the filed GCR Plan.
>
> However, if the cumulative increase in the First and Second Quarters exceeds $0.50 and/or market volatility shows that an increase of up to $1.00 is necessary in the Second Quarter alone, then the Company may increase the Filed GCR Factor by any amount up to $1.00 in the Second Quarter. The maximum increase to the Filed GCR Factor is limited to $1.00 overall for the first two quarters.
>
> 3. The Third Quarter review made in any month would follow the same process as the Second Quarter review except the cumulative increase would be raised to $0.75 and market volatility would be raised to $1.50. The maximum increase to the Third Quarter GCR Factor is limited to $0.75 and the maximum increase to the Filed GCR Factor is limited to $1.75 overall for the first three quarters.
>
> 4. The Fourth Quarter review made in any month would raise the cumulative increase to $1.00 and market volatility to $2.00. The maximum increase to the Fourth Quarter GCR Factor is limited to $0.75 and the maximum increase to the Filed GCR Factor is limited to $2.50 overall for the GCR Year.

Under this plan, there are "potential GCR increases of $.50 in the first quarter of the GCR period, $.50 in the second quarter, $.75 in the third quarter and $.75 in the fourth quarter for a total of $2.50." RRC Initial Brief, p. 10. RRC argues that this proposal "reduces rate shock and price volatility that would otherwise occur with larger contingency factor increases in the competing mechanisms and allows the utility to collect at a higher monthly billing rate in those months when most of the gas is consumed." RRC Initial Brief, p. 10. "This method also allows the utility to capture intra-Quarter price increases that the current method does not." RRC Initial Brief, p. 10.

RRC states, at RRC Initial Brief, pp. 10-11.

> In summary, the contingency mechanism the RRC proposes . . . is a viable option for addressing price volatility that may occur in a GCR period. The Company's fixed price purchasing program should not be the vehicle for controlling price volatility because the evidence shows that the premium GCR customers have paid for that approach to purchasing gas is excessive and unreasonable.

Consumers opposes the RRC's proposed contingency mechanism. Consumers argues that the RRC's proposal fails to meet its stated goal of being a simplified mechanism. Consumers argues the mechanism should be rejected because it makes "calculations more complex" and "difficult to understand", the analysis would change quarterly, each quarters' results depend on the prior quarters' results, the "time frame for analysis is not entirely clear", it "would not necessarily result in price stability", it would require NYMEX comparisons, and it provides customers with less certainty about billing amounts. Consumers Initial Brief, p. 21, pp. 51-52.

The RRC takes umbrage with Consumers' criticism states, at RRC Reply Brief, pp. 3-4:

> Consumers . . . criticizes the RRC's proposal for replacing the existing contingency mechanism as:
>
> - not as simple as the Staff's proposed mechanism
> - making calculations more complex and difficult to understand
> - not well defined
> - not necessarily resulting in price stability.
>
> At the outset it is important to understand that the purpose of the GCR contingency mechanism is to mitigate the possibility of very large underrecoverries associated with price volatility. By its very nature, any contingency mechanism works against price stability because its end result is a change in the GCR factor.
>
> . . . Consumers' other criticisms . . . are not supported by any reasoned analysis. The description of the RRC's contingency method contained in Mr. Hollewa's testimony and in the RRC's initial brief shows that it is very simple and structured. It is designed to provide the utility flexibility to change the GCR factor up to the specified quarterly limits based on its appraisal of gas cost price changes while requiring documentation that supports the Company's exercise of this discretion. Moreover, Consumers fails to recognize that [because] this proposal phases in contingent GCR factor increases through the GCR year [the proposal]:
>
> - reduces rate shock and price volatility for GCR customers that would otherwise occur with larger contingency factor increases
> - allows the utility to collect at a higher monthly billing rate in those months when most of the gas is consumed.
> - allows the utility to capture intra-Quarter price increases that

the current method does not.

Staff is critical of the RRC’s proposal because the “mechanism contains four different contingent factor caps, for each quarter, which would allow increases for certain quarters based on the previous quarter's adjustment to the factor”, because it does “not provide GCR customers with more certainty regarding the amounts on their bill, and it is not “able to mitigate under-recoveries as well as the Staff's proposal.” Staff Reply Brief, pp. 3-4.

“The Attorney General is concerned that RRC's alternative [contingency mechanism] . . . confers too much discretion upon CECo and would grant CECo virtually the same power to raise its billed GCR factor above the $6.9934 amount CECo has proposed under MCL 460.6h(6).”

While not directly addressed in his briefs, it appears that the Attorney General is proposing continuation of the current contingency mechanism, with the exception that he supports Consumers’ method for calculating the levelized multiplier rather than the, currently, Commission approved method proposed by Staff.

DISCUSSION

Statutory Provisions

MCL 460.6h reads, in part:

> (3) In order to implement the gas cost recovery clause . . . a utility annually shall file . . . a complete gas cost recovery plan describing the expected sources and volumes of its gas supply and changes in the cost of gas anticipated over a future 12-month period . . . and requesting for each of those 12 months a specific gas cost recovery factor. . . . The plan shall describe all major contracts and gas supply arrangements . . . for obtaining gas during the specified 12-month period. The description of the major contracts and arrangements shall include the price of the gas, the duration of the contract or arrangement, and an explanation or description

of any other term or provision as required by the commission. The plan shall also include the gas utility's evaluation of the reasonableness and prudence of its decisions to obtain gas in the manner described in the plan, in light of the major alternative gas supplies available to the utility, and an explanation of the legal and regulatory actions taken by the utility to minimize the cost of gas purchased by the utility.

(4) In order to implement the gas cost recovery clause . . . , a gas utility shall file, . . . with the gas cost recovery plan . . ., a 5-year forecast of the gas requirements of its customers, its anticipated sources of supply, and projections of gas costs. The forecast shall include a description of all relevant major contracts and gas supply arrangements entered into or contemplated between the gas utility and its suppliers, a description of all major gas supply arrangements which the gas utility knows have been, or expects will be, entered into between the gas utility's principal pipeline suppliers and their major sources of gas, and such other information as the commission may require.

(5) If a utility files a gas cost recovery plan and a 5-year forecast . . . the [C]ommission shall conduct a proceeding . . . for the purpose of evaluating the reasonableness and prudence of the plan, and establishing the gas cost recovery factors to implement a gas cost recovery clause incorporated in the rates or rate schedule of the gas utility. . . .

(6) In its final order . . . , the [C]ommission shall evaluate the reasonableness and prudence of the decisions underlying the gas cost recovery plan . . . and shall approve, disapprove, or amend the . . . plan accordingly. In evaluating the decisions underlying the gas cost recovery plan, the [C]ommission shall consider the volume, cost, and reliability of the major alternative gas supplies available to the utility; the cost of alternative fuels available to some or all of the utility's customers; the availability of gas in storage; the ability of the utility to reduce or to eliminate any sales to out-of-state customers; whether the utility has taken all appropriate legal and regulatory actions to minimize the cost of purchased gas; and other relevant factors. The commission shall approve, reject, or amend the 12 monthly gas cost recovery factors requested by the utility in its gas cost recovery plan. The factors ordered shall be described in fixed dollar amounts per unit of gas, but may include specific amounts contingent on future events, including proceedings of the federal energy regulatory commission or its successor agency.

(7) In its final order . . ., the [C]ommission shall evaluate the decisions underlying the 5-year forecast filed by a gas utility . . . . The [C]ommission may also indicate any cost items in the 5-year forecast that on the basis of present evidence, the commission would be unlikely to permit the gas

utility to recover from its customers in rates, rate schedules, or gas cost recovery factors established in the future.

None of the parties argue that Consumers' application is statutorily insufficient. Rather, to various degrees, the parties argue that certain aspects of the Plan should be amended or not approved.

Base GCR Factor

Consumers has proposed a base GCR factor of $6.9934/ Mcf. No party objects to this figure.

Contingency Mechanism

The parties have proposed, what amounts to, three separate contingency mechanisms. For the reasons explained below, I recommend that Consumers' Plan be amended to include continuation of the currently approved contingency mechanism adjusted to include Consumers' proposed base factor of $6.9934/Mcf and Staff's levelized fractional multiplier of 0.3313.

Staff's proposes a different mechanism that incorporates Consumers' base GCR factor of $6.9934/Mcf, uses a levelized fractional multiplier of 0.3313, and an adjustment cap of $2.50/Mcf to arrive at its "Maximum Allowed GCR Factor Adjustment" permitting Consumers to bill up to $7.8217/Mcf. Staff's proposal allows Consumers to adjust the base factor upward for events not associated to changes in the price of gas and does not require Consumers to justify its actions, prior to any rate changes.

Staff supports this proposal by arguing that the Act permits more than just gas price to be considered in a contingency mechanism; that the mechanism would provide Consumers greater flexibility in setting rates, thus, better avoiding over/underrecoveries;

that it's easier to understand and administer, and; that it provides GCR customers greater certainty in rates.

Consumers supports this proposal and adds that it has no incentive to overcharge, that it provides them greater flexibility to respond to changes in the NYMEX market, and that they will not change their method for determining the monthly GCR billing factor.

The Attorney General argues that Staff's proposal is not statutorily permitted because it permits rate increases that are not contingent upon any specific future event.

RRC opposes the proposal and characterizes it as a "blank check" to increase the GCR factor without establishing any contingency to justify an increase. Like the Attorney General, RRC argues that such a mechanism is not authorized by statute.

Without addressing the legality of Staff's proposal, I find that, vis-à-vis the alternatives, it is not preferable.

Staff promotes its proposal as being easier to administer. Ease of administration is a laudable goal. However, evidence has not been presented to establish that the current mechanism is overly complex and/or difficult to administer. Furthermore, Consumers indicates Staff's mechanism will not change the way it sets the GCR billing factor. Thus, any simplification of the current mechanism appears unnecessary.

Staff also argues that the mechanism will be easier to understand. That may be true with regard to the manner in which Staff has calculated the maximum allowed factor. However, what is unclear and not understandable is how and under what conditions Consumers may implement rate changes under the mechanism. Additionally, under Staff's proposal, Consumers is not required to explain and justify the changes when they occur. This lack of transparency, seems to belie another of Staff's claims; that its proposed mechanism will provide customers "more certainty in the amount billed."

Staff points out that Consumers considers a number of variables when developing its plan and GCR base factor. Staff argues that "one incorrect" assumption can change the rates necessary for full cost recovery. Thus, Staff considers this reason to detach the mechanism from NYMEX price changes. While this is a reasonable concern to address, I can not recommend a contingency mechanism that permits Consumers to, without justification, make rate changes to correct for incorrect assumptions. Furthermore, because the proposal provides Consumers an easy fix for incorrect assumptions, such a policy may have the unintended consequence of increasing the likelihood that such incorrect assumptions are made.

I do find desirable, Staff's proposal to allow Consumers to adjust prices monthly, rather than quarterly. However, the disadvantages, stated above, make Staff's proposal less reasonable than the current mechanism and I cannot recommend its inclusion in Consumers' Plan.

With regard to the RRC's proposed contingency mechanism, while I believe it has certain advantages, I agree with Consumers' observation that the proposal is not well defined. Therefore, I cannot find it a more reasonable alternative to the current mechanism.

As an alternative to Staff's proposal, Consumers recommends adoption of the mechanism it originally proposed in this filing. This proposal is substantially the same as that proposed, and mostly adopted, in Case No. U-15704. Consumers proposes to use the higher of change in the entire 12-month GCR NYMEX strip or of the remaining GCR NYMEX strip from the Plan NYMEX each quarter, a $3.00 ceiling factor cap on the change in NYMEX prices, and a levelized fractional multiplier of 39.4%. (For a more detailed description of the proposed mechanism, see Tr 2, pp. 269-74.)

Consumers' proposal to use either the 12-month strip or the remaining strip was rejected by the Commission in Case No. U-15704. None the less, Consumers renews this proposal based on its assertion that it facilitates the timely recovery of GCR costs. I believe that, intuitively, this proposal appears to make sense, is reasonable, and, in general, I view it favorably. However, Consumers presents little more than conjecture, couched in limiting phrases such as "would have likely" and "could result" to establish the benefits of the proposal. See Tr 2, pp. 271-72. Furthermore, when served with an Attorney General discovery request to provide specific calculations showing the benefits that Consumers' claims the use of the two strips will provide, Consumers declined to do so. See Exhibit AG-1. Lastly, Consumers has presented no evidence to suggest any changed circumstance that would warrant reversal of the Commission's position that was announced just a few short months ago. As a result, especially in light of its recent rejection by the Commission, Consumers has failed to establish the reasonableness of this portion of the proposed mechanism and it should be amended accordingly.

Therefore, I recommend approval of Consumers' proposed contingency mechanism with two amendments. First, only the entire 12-month NYMEX strip may be used for computational purposes. Second, the levelized fractional multiplier should be set at 0.3313, as calculated by Staff, pursuant to its previously approved formula.

Gas Purchasing Strategy Guidelines[6]

Consumers proposes, and Staff supports, continuation of the current gas purchasing guidelines, as approved by the Commission on March 2, 2010, in Case No. U-15704. This would continue use of both Consumers' Tiered Fixed Price Purchasing Guidelines and its Quartile Fixed Price Triggers Guidelines.

Under the tiered guidelines, Consumers strives to secure fixed prices for certain minimum quantities of gas by certain deadlines. The current tiered guidelines call for, at least, 15-20% of the gas for the GCR period to be under fixed prices by December 1st of the preceding year, at least, 25-30% by the beginning of the GCR year, at least, 35-40% of the November through March requirements by July 1st of the GCR year, and, at least, 50% of the November through March requirements by October 15th of the GCR year.

Gas purchasing will be evaluated on a monthly basis. After April 1st, if such evaluation results in a GCR factor exceeding the authorized factor, gas purchasing for November through March shall be accelerated to achieve the July 1st target within 30 days. After July 1st, if such evaluation results in a GCR factor exceeding the authorized factor, gas purchasing for November through March shall be accelerated to achieve the October 15th target within 30 days.

Under the quartile guidelines, each month, Consumers will determine the average of the settlement prices for the NYMEX contract that has settled for the current month and the next consecutive eleven months. This 12-month average strip price will be compared to 12-month average strip prices for the previous 35 months. All 36 prices will be grouped into quartiles with the nine lowest prices representing the first quartile and the next nine prices falling in the second quartile. If the current market price of gas

[6] See Exhibit A-21 for the entire guidelines, as originally proposed.

falls into the second quartile, or below, Consumers will fix prices on a portion of its supply requirement for the balance of the current GCR Plan year and the next three GCR Plan years.[7]

As noted, Consumers is proposing that the Commission adopt the same quartile purchasing percentages as were approved in Case No. U-15704. If I have interpreted the Commission's Order[8] correctly, when the 12-month strip's average falls into the second quartile, Consumers will fix prices on up to 20%, 20%, and 10% of the remaining gas requirements for the remainder of the current GCR year, the second GCR year, and the third GCR year, respectively. When the averages fall into the first quartile, Consumers will fix prices on up to 25%, 20%, 15%, and 10% of the remaining gas requirements for the remainder of the current GCR year, the second GCR year, the third GCR year, and the fourth GCR year, respectively. When the averages fall below the first quartile, Consumers will fix prices on up to 35%, 35%, 25%, and 10% of the remaining gas requirements for the remainder of the current GCR year, the second GCR year, the third GCR year, and the fourth GCR year, respectively.

Total fixed price purchases are capped at 90% of the total GCR requirements for the current year, 60% for the second and third years, and 20% for the fourth year. If contracts are available at below first quartile prices, the caps for the second and third GCR years increase to 70%.

Discretion in administering the guidelines is the responsibility of the Senior Vice President of Electric and Gas Supply.

[7] For the fourth year, purchases are permitted only for prices in the first quartile, or below.
[8] See page 18 of the Commission's March 2, 2010 Order in Case No. U-15704.

The Attorney General argues that the guidelines should be amended to cap GCR third-year second-quartile purchases at 20% of that years projected gas requirements. To support this amendment, the Attorney General points to the fact that, over the past four years, Consumers' fixed price purchasing practices have cost customers an estimated $750 million through higher rates.

RRC proposes more aggressive changes to Consumers' fixed price purchasing guidelines. In essence, RRC recommends abandonment of the current guidelines and, with a few exceptions, advance fixed price purchasing. Under the RRC's plan, Consumers would be allowed to fix the price of up to 50% of its September 2010 volumes any time during June through August. For up to 50% of its October 2010 purchases, Consumers may fix the price any time from June through September[9]. For 50% of Consumers' November 2010 through March 2011 heating season requirements, Consumers would be permitted to fix the price any time during April through October if the average strip price is $5.00, or less.

To ensure the same level of firm supply that Consumers obtains under its current fixed price purchasing policies, RRC recommends a mixture of strategies that, in addition to the fixed price purchasing strategy described above, includes, among other things: long-term contracts priced at, or near, index for the applicable production area; seven month contracts for summer and five month contracts for winter based on NYMEX close, plus or minus, a fixed basis adjustment for the applicable production area; and monthly purchases at FOM and NYMEX close.

[9] At Tr 2, p. 414, Mr. Hollowa explains that he anticipates this strategy to be implemented in future years and acknowledges that the policy is meaningless for this GCR year because Consumers has fixed the price of, nearly, all its projected gas requirements.

The parties have not seriously, if at all, contested the RRC's observation that, over the past four GCR years, Consumers' fixed price purchasing strategies have cost its customers an additional $752 million. The only real question is what to make of this. Consumers and, to a lesser degree, Staff seem content with the current purchasing policy. Consumers argues that the RRC's proposal should be rejected because price is not the only consideration to be made and that other considerations such as an assured supply, price stabilization, reduced volatility, and a need to increase purchases as winter approaches makes its fixed price purchasing policies worth potentially higher costs. Additionally, Consumers argues that its purchasing policies are sound because no one can predict future prices and, therefore, they may prove advantageous. However, at the same time, Consumers presents no evidence to suggest that conditions will change to make its purchasing policies less costly or, for that matter, under what conditions its current policies will prove more cost effective. I find this position very unsatisfying.

The RRC has presented alternatives that will ensure supply and, if recent market conditions continue, provide, it argues, substantial savings for customers. The RRC's evidence suggests that prices are likely to remain steady and avoid "significant price spikes". Its witness, Mr. Hollewa, indicates that the word "glut" has resurfaced in the gas industry and that increased gas production from shale now outpaces the hurricane affected southeast production. He indicates that, therefore, there is less concern about the threat of hurricane caused disruptions of natural gas supply. Additionally, because he anticipates continued decreased demand and increased supplies, Mr. Hollewa expects gas prices to remain relatively stable. Furthermore, based on the evidence presented, it appears reasonable to assume there exists an upward price bias in the natural gas futures market.

Based on the record, the reasonableness of the competing proposals is difficult to judge. Clearly, over the past four years, when compared to the alternatives, Consumers' gambling in the futures market has proved expensive for its customers. With little more than opinion testimony, Consumers claims this expense is warranted to ensure supply and provide price stability. Again, based, largely, on opinion, the RRC has presented an alternative strategy that it claims will ensure supply and, hopefully, reduce cost.

While not satisfied with the state of the evidentiary record in support of Consumers' proposal, I cannot find that the RRC's proposed purchasing policy is superior to Consumers' and should be substituted for it in the Plan. However, components of it are worthy of consideration. Given that the RRC has indicated that gas supply appears strong, demand weak, and that an upward price bias exists, it appears reasonable for adjustments to be made to Consumers' current fixed price purchasing policy.

The RRC has recommended a greater reliance on various long-term contracts that would ensure supply while allowing prices to settle more closely to the cost of gas at the time of delivery. I believe this policy should be encouraged and, therefore, recommend modest amendments to the caps on total fixed price purchases. Caps on total fixed price purchases should be lowered to 80% of the total GCR requirements for the current year, 50% for the second and third years, and remain at 20% for the fourth year. The caps for the second, third, and fourth GCR years may be exceeded by up to

10 percentage points through the purchase of gas at below first-quartile prices. Furthermore, I adopt the Attorney General's recommendation to cap third GCR year second-quartile purchases at 20% of the year's projected gas requirements. In addition, given that the evidence suggests relatively stable, if not falling, gas prices, I recommend that the 20% second quartile cap be expanded to cover the second GCR year, also.

To permit Consumers greater flexibility in its purchasing decisions, I recommend that the mandatory fixed price purchasing percentages and deadlines found in Consumers' Tiered Fixed Price Purchase Guideline be removed from the plan. It appears ill-advised to design a purchase policy that requires Consumers to fix the price on certain percentages of its gas needs by set dates, regardless of the then market conditions. Currently, it appears the operation of this guideline has been temporarily supplanted by purchases pursuant to the quartile fixed price triggers. However, in the absence of quartile purchases, Consumers should have the flexibility to fix prices when, after analysis and application of professional judgment, it is determined that price fixing is warranted. To be clear, Consumers would be permitted to fix gas prices in a manner consistent with the current tiered purchasing guidelines; it just wouldn't be required to do so. To the degree the tiered guidelines are designed to ensure supply, nothing would restrict Consumers' ability to secure supply under the various contractual arrangements presented by the parties to this case. Furthermore, Consumers' reliance on analysis and professional judgment will have the added benefit of encouraging the heightened analysis and honing of it purchasing decisions rather than permitting such decisions to degenerate into a Commission approved rote exercise.

Finally, in Case No. U-15704 the Commission found “that the parties should be encouraged to engage in discussions designed to identify changes to the guidelines”. In this regard, if any effort was made, it has failed. Unfortunately, within the confines of this Plan case, it appears not possible to engage in a thorough examination of Consumers’ physical constraints, possible supply constraints, long-term supply and demand, and other economic and non-economic factors that impact Consumers’ purchasing policies and decisions. Rather than again encouraging the parties to discuss purchasing policies, I recommend that a separate docket be opened for that purpose.

Gas Allocation

In the course of examining Consumers’ Application, the RRC discovered inconsistencies in Consumers’ gas allocation for the winter months. As an alternative, the RRC recommended allocation percentages based on an 11-year average. In response, Consumers reluctantly acknowledged an unspecified calculation error and, rather than correcting the error or adopting the RRC’s 11-year average, proposed use of a four-year average. Consumers claims the four-year average captures “structural change” to gas sales since hurricanes Katrina and Rita in 2005. The structural change identified by Consumers appears to be reductions in, overall, annual sales. With regard to annual sales, use of the four-year average results in 73.6% being allocated to the winter months and use of the 11-year average results in 73.7% being allocated to the winter months. Greater variance is, however, found when one compares the results for the individual months. Compared to the eleven-year average, the four-year average is more susceptible to the introduction of error by a single or a very few unusually warm or cold months. Therefore, I find that the Plan should be amended to include monthly allocations of sales based on an 11-year average.

Late Season Purchasing

At page 10 of its December 16, 2009, Order in Case No U-15041-R the Commission stated:

> The Commission agrees that there appears to be some evidence that the company's late-season purchasing strategy could be improved. Consumers may wish to present a refinement to its purchasing methods in a future GCR plan proceeding. Intervenors in future GCR plan cases are also encouraged to analyze past results and provide recommendations for alternative strategies for Commission consideration.

At Tr 2, p. 388, Mr. Hollewa testified that, in reference to its late season purchases:

> The Company's testimony on this issue was based on business as usual. It uses words such as "supply risk", "operational uncertainties" and "cost risk" to avoid making a serious examination of whether it can reduce GCR costs for its customers by refining its late-season purchasing strategy. I also agree that all of these concerns need to be addressed, but it should be through analysis and documentation that some efforts were made to justify the existence and validity of any and all concerns. The Company's testimony on this subject failed in this respect.

I find Mr. Hollewa's statement to be an accurate assessment of the effort and tactics that Consumers appears to have made and adopted in addressing the issue of late season purchases. While, in Case No. U-15041-R, the Commission did not order Consumers to refine its late season purchasing strategies, it certainly suggested so. In this filing, Consumers purports to address the Commissions' suggestion in the testimony of Ms. Harvey and Mr. Howard. It appears that this testimony is little more than a description of its current purchasing strategies and a laundry list of concerns that need to be addressed in any late season purchasing strategy. Given the Commission's guidance, if Consumers determined that no change is warranted, I would expect the presentation of evidence to provide a reasonably in-depth explanation of why the current methods are preferred.

Instead, in addition to the proffered excuses that the RRC identifies, above, Consumers states that delayed incremental purchases would create uncertainties regarding: the “level and basis of purchases” to plan for “prior to the start of the month”; the “timing” of “incremental purchase decision[s]”; the “basis for the incremental purchases for the month for the remaining period”, and; “the impact of operational constraints”. Consumers adds that “[g]uessing wrong . . . could have dire consequences“.

I find that none of this testimony establishes reasons to maintain the status quo with regard to late season purchases. Rather they are, as the RRC notes, matters to be addressed, evaluated, and quantified in examining changes to late season purchasing policies. Furthermore, Consumers’ suggestion that it is being asked to make guesses is without merit and merely a distraction. In sum, I do not believe Consumers has seriously addressed the Commission’s recommendation.

In Case No. U-15041-R, not only did the Commission suggest Consumers examine its late season purchasing, it also “encouraged” intervenors to “provide recommendations for alternative strategies for Commission consideration.” In an effort to do so, RRC submitted discovery question RRC-5, which reads as follows:

> **RRC-5** Please refer to Mr. Howard’s testimony on Page 19, line 8 through Page 20 and answer the following:
>
> a. Provide any studies performed by Consumers to examine the issue of delayed purchases.
>
> b. Define and explain all of the operational uncertainties that would be created.

c. Define and explain the increased supply risk.

d. Define and explain the cost risk to customers based on a 1-in-25 chance of occurrence versus the reduced March purchases in 24 out of 25 years.

In answering the above questions, please consider the following assumptions:

- Assume the March purchase requirement is estimated at 5,600 MMcf, or 180 MMcf/D.
- Purchase 50% (2,800 MMcf @ 90 MMcf/D) on or about 2/18 as usual. Purchase half as Citygate and half from FT.
- Review actual for 10 days in February and use 10-day forecast for March on 2/28. If the result is more than 8% CTN, purchase 25% (1,400 MMcf @ 45 MMcf/D) on or about 3/01. Again, purchase half as Citygate and half from FT. The second purchase represents 16% CTN or a safety margin of 8%.
- If no purchase is required based on 2/28 review, then the purchase of 25% should be made at any time the actual-to-date plus 10-day forecast exceeds 5% CTN due to the reducing number of days. The first purchase of 50% represents 10.7% CTN or a safety margin of 5.7% pending the 5% CTN trigger.
- If the purchase was required based on 2/28 review or the 5% CTN trigger, then the purchase of the final 25% should be made at any time the actual-to-date plus 10-day forecast exceeds 10% CTN. Use the 55 MMcf of remaining FT plus the balance from Citygate purchases. For example, if the actual for the 1 ten days in March plus the 10-day forecast is 10% CTN, the purchase of 1,400 MMcf for 20 days @ 70 MMcf/D would use 55 MMcf/D from FT and only 15 MMcf/D from Citygate purchases. Tr 2, p. 389.

In response, Consumers stated:

a-d. Please see my direct testimony on page 19, line 8 through page 21, line 5 and the Consumers Energy witness Lori Harvey's testimony on page12, line 1 through page 13, line 20, page 14, line 1 through page 17, line 21, and page 28, line 19 through page 29, line 20. Tr 2, p. 389.

A review of the referenced testimony shows that Consumers' discovery answer was nonresponsive. Thus, not only has Consumers failed to present evidence that it undertook a serious examination of its late season purchasing policies, it has stonewalled the RRC's efforts to develop reasonable alternatives.

Based on the prior orders of the Commission and the record presented in this case, Consumers has failed to present sufficient evidence to support a finding that its late season purchasing policy is reasonable and, therefore, that part of the plan should not be approved.

Buy/Sell Activity

For the reasons cited by Consumers, I recommend no action be taken with regard to buy/sell activity. The Attorney General is free to develop this issue in greater depth, through discovery, in future cases.

CONCLUSION

For the reasons stated above, I recommend Commission approval of Consumers' proposed 2010-2011 Gas Cost Recovery Plan with the following amendments:

A. The contingency mechanism price adjustment calculations shall use the entire 12-month NYMEX strip, only, and a levelized fractional multiplier of 0.3313.

B. Total fixed price purchases shall be capped at 80% of the total GCR requirements for the current year, 50% for the second and third years, and 20% for the fourth year. The caps for the second, third, and fourth GCR years may be exceeded by an additional 10 percentage points through purchase of gas at below first quartile prices.

C. Second quartile purchases for the second and third GCR years are capped at 20% of each year's projected gas requirements.

D. To the degree that the tiered purchasing percentages and deadlines are considered mandatory, they are removed from the Plan.

E. Gas sales monthly allocations are amended to be based upon an 11-year average.

F. Consumers late season purchasing policy is not approved.

Any arguments not specifically addressed in this Proposal for Decision were deemed irrelevant to the findings and conclusions of this matter.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

Mark D. Eyster

Digitally signed by Mark D. Eyster
DN: cn=Mark D. Eyster, c=US,
email=mdeyste@michigan.gov
Date: 2010.09.14 13:25:28
-04'00'

Mark D. Eyster
Administrative Law Judge

ISSUED AND SERVED: September 14, 2010